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BUILDING STRATEGIES FOR FUTURE — A PROFESSIONAL'S PERSPECTIVE

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I. THE CHANGING PARADIGM

The world is moving at a breakneck speed and the advancement in communication and information technology is the striking feature of contemporary society. The transfer and transmission of large volumes of data and information to remote corners of the world has brought about a qualitative change in economic, social and political thinking. Capital markets have been practically interconnected. As news spreads all over the world within moments, distance loses its importance. The violation of human rights and destruction of environment become equally important, whether they occur in a neighbouring country or at the other end of the world.

Similarly as a consequence of increasing interconnectedness and interdependence, the structures of national governance are all for change in the course of globalisation. The quest for more mobility and efficiency has compelled the nations to open up their borders and allow globalisation to expand and grow, however, within the national governance system.

One of the basic indicators of the maturity of any profession is its continual capacity to adapt itself to the constantly changing scenario. Times have never been as challenging for the professionals in the corporate sector as the incidences of corporate debacles, one after the other, and the shrinking of once commercial giants seems to echo and underline today. With the sharp focus on maintenance of good governance, as the key to standing tall in the turbulent seas of today's business world, it is incumbent upon the profession of Company Secretaries to unflinchingly demonstrate in the ensuing scenario that the profession is eminently suited in its capacity of being the principal driver of corporate governance and the custodian of ethical well being of the company. All challenges brought about by change embody opportunities sometimes appearing as problems to scare away the unprepared and which can only be seized by

those prepared to ride courageously on the winds of change.

The profession should not only know what it ought to do, but must actually do in order not to leave any action gap. Such action gaps, if allowed to exist, will not only affect the day-to-day activities in the profession, but will also affect strategic actions vital for renewal of the profession. Actions for building future strategies will not only articulate the purpose and goals of the actions, the professionals should also know what they are doing and why. Building future of a profession would need an unclouded commitment on the part of the professionals. This should move beyond motivation to generating personal volition to build up the future. Such a volition suppresses any doubts, receptiveness to distractions and provides force to deal with any setbacks or obstacles. Leading the change is far different in degree and character than responding to the change. The theme of this Convention needs Company Secretaries to think on future leadership of the profession in contrast to followership or responding to change. The major drain on the energies of the profession is the perception of having limited influence. This perception nurtures a feeling of being externally determined and undermines the capacity of the profession to identify itself with the tasks ahead. As professionals, Company Secretaries need to discover and identify choices they have which might have been insufficiently exploited and pursued. As strategic managers, Company Secretaries should be more aware of their choices and make conscious use of them in order to extend their freedom to act. The need of the hour is to make oneself less reactive and dependent upon demands of others.

Advent of Information Age

The information society is not just a product of information technology but an outcome of a dynamic interplay of a set of intermeshed and interacting social and technological dynamics which includes information

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processing and telecommunication and an increasing convergence of progressively escalating levels of specialization in the economy, and the emergence of a better informed and vigilant society which not only requires but demands better governance.

The information age has created a society and corporate climate, which is richly interconnected. Looking at the information age related consequences in the social and economic milieu, one is forced not only to acknowledge each one of the following information age driven developments, but also to devise actions to deal with each one of them:

- interconnected stock exchanges across the world;
- border-less capital markets;
- increasing rationalization of business on a global basis;
- the growing importance of supranational institutions like the WTO and GATS and ever present information networks making transborder transactions instant.

Each one of the above developments requires proactive study and response system to help the profession add value to corporate clients in a visible way.

In the information age, countless ways and multiple channels of information access have sought to bid a gradual farewell to the era of secrecy. Progressive legislations, demands of competitive parity and indeed the imperative to seek and join the global main stream have made information not only a requirement for corporate stakeholders but also a right to be demanded and exercised. From a manager of confidentiality and secrecy to a hub of disseminable and sharable requisite information, there is a paradigm shift in the role of the Company Secretary. Understanding the imperative to change and rising to the occasion by becoming a stakeholder friendly, reliable and readily available information resource for sharable information is the role profile that the Company Secretaries would have to adopt and master.

Each of these developments translates into an enlargement of the role and responsibility of the Company Secretary in dealing with the portends of good governance in the information age, in managing information and disclosure flows with literally the speed matched by the requirements of an interconnected world and dealing with both conventional and unconventional corporate structures.

New Structure and Styles of Business Operations

In their quest of sustainable competitive advantage and faster speed of response, organizations both public and private, are downsizing, outsourcing, networking or simply relying on more decentralized, flatter, leaner structures to enable themselves to have higher levels of market responsiveness and client focus as well as to retain advantages of flexibility to remain in sync with a world of changes bringing in unexpected opportunities as well as the threat of getting their competitive advantages wiped out. Being an important function in corporate decision making in companies, the Company Secretary is ideally placed to emerge as the repositior of all the validation and legal requirements regarding company operations in multiple locations, varying time zones and constantly shifting structural forms.

As professionals, Company Secretaries should also not be carried away by trends in the corporates like downsizing. There are many companies in the midst of this wave of slimming down to remain competitive that take an exactly contrary action . The following research and new corporate culture exemplifies this point.

Laurie Bassi and Daniel McMurrer in HBR March 2004 say that companies that invest in employee development can outperform the market. "Layoffs actually destroy shareholder value". Bassi is a CEO of Human Capital Capability. The company is a research-based benchmarking company that specializes in measuring return on investment in people. She is the Chairwoman of the Board of Directors of "Knowledge Asset Management" [KAM], an investment company that specializes in investing in firms that invest in their people.

Long-range value of a company improves even more as the company invests in its workers instead of relying on cheap labour. Companies which made significant investment in their employees consistently reaped greater long-term stock performance than those who sought short term profitability.

KAM began watching 40 companies that invested at roughly twice the industry norm in employee development consistently between 1996 and 1999, and tracked their performance through 2001.

Their returns were robust and in line with a growing body of empirical research showing that organizations that made extraordinary investments in people often enjoy extraordinary performance on a variety of indicators, including shareholder return.

KAM decided to put its money where its research was and so "created a live portfolio of companies that spend aggressively on employee development."

In 25 months since December 2001, the portfolio outperformed the S&P 500 index by 4.6 percentage points. Having seen positive results, KAM expanded its investment strategy and launched two additional live equity portfolios in January 2003. Each of the three portfolios exceeded the S&P 500 index for 2003 by 4.7 to 9.3 percentage points.

The above example will require Company Secretaries, specially in the Indian context, to devise actions that lay emphasis on investments in human resources to enable their clients stay ahead in corporate value generation.

When firms operate in markets other than their own domestic market, they often need to recreate their competitive advantage. One of the sources of competitive advantage under such scenario could be the level of professionalisation of the various services available in the host countries. The contention here is that, to an incoming corporate in India, a key resource base should be the quality of company secretarial professional services available, which through complete mastery of legal and secretarial operations would not only free the corporate think tank from the concerns of legality of corporate actions, but also render timely and requisite advisory services, regarding governance and other corporate requirements in the host country.

Market Oriented Regulatory Ambience

With the initiation of economic reforms process in July 1991, the Government has initiated the process of Legislative Reforms to suit the changing policy orientation and to fulfill its obligations under WTO. In the process, the Government enacted various new laws, amended existing legislations and some Bills are awaiting nod of the Parliament, to provide a conducive economic and corporate legal environment. Some of them are enumerated below:

Enactment of New Legislations

- (i) Securities and Exchange Board of India Act, 1992;
- (ii) Depositories Act, 1996;
- (iii) Arbitration and Conciliation Act, 1996;
- (iv) The National Environment Appellate Authority Act, 1997;
- (v) Trade Marks Act, 1999;
- (vi) Telecom Regulatory Authority Act, 1997;

- (vii) Foreign Exchange Management Act, 1999;
- (viii) Insurance Regulatory and Development Authority Act, 1999;
- (ix) Central Electricity Regulatory Commission Act, 1999;
- (x) Geographical Indications of Goods (Registration and Protection) Act, 1999;
- (xi) Information Technology Act, 2000;
- (xii) Designs Act, 2000;
- (xiii) The Semiconductor Integrated Circuits Layout Designs Act, 2000;
- (xiv) Securitisation Act, 2002;
- (xv) Competition Act, 2002;
- (xvi) Electricity Act, 2003.

Amendments to Existing Legislations

- (i) The Indian Electricity (Amendment) Act, 1991;
- (ii) The Electricity (Supply) (Amendment) Act, 1991;
- (iii) Sick Industrial Companies (Special Provisions) (Amendment) Act, 1993;
- (iv) Monopolies and Restrictive Trade Practices Act, 1969 (amended in 1991 & 1993);
- (v) Motor Vehicle Act, 1988 (Amended in 1994);
- (vi) National Highways Act (Amended in 1995);
- (vii) Securities (Contracts) Regulations (Amendment) Act, 1996;
- (viii) Securities laws (Amendment) Act, 1999;
- (ix) Companies (Amendment) Act, 1966, 1999, 2000, 2001, 2002 (twice);
- (x) Copyright (Amendment) Act, 1994 & 1999;
- (xi) Patents (Amendment) Act, 1999;
- (xii) Code of Civil Procedure (Amendment) Act, 1999;
- (xiii) The Recovery of Debts Due to Banks and Financial Institutions (Amendment) Act, 2000;
- (xiv) Consumer Protection (Amendment) Act, 2002;
- (xv) Negotiable Instruments (Amendments) Act, 2002.

It is, therefore, imperative for Company Secretaries not only to sharpen their core competencies but also diversify in new and emerging areas, thrown open by market oriented regulatory ambience. These areas include intellectual property rights, mergers and acquisitions, arbitration and ADR modes, insurance, due diligence, foreign collaborations and joint ventures.

Sharp Focus on Good Corporate Governance

With the advent of “Global Village” the concept of universality as envisaged by our elders that the entire universe is one (“Vasudhaiva Kutumbakam”), has become a virtual reality now. Thanks to mind boggling scientific technological advancements pronouncing the death of distance and speeding up communication, people contacts have become instantaneous across the nations. Knowledge constantly makes itself obsolete – with the result that today’s advanced knowledge is tomorrow’s ignorance. One has to be on the learning curve and continuously move up. All the knowledge workers have to leverage intellectual capital for growth – creative destruction – keep on innovating – otherwise some one else will be at the top of the pecking order.

The assumption that business and ethics are adversaries and whose co-existence is impossible, no longer holds true in today’s globally competitive corporate landscape. The trade-off between good governance and the lure for higher profits has always been the dilemma of businessmen. The deep-rooted belief that as long as the performance is good, corporate governance is not an issue of great significance has outlived its relevance in view of the periodic crises in the market. It has now been widely recognized that outstanding performance, higher profits and expanded reach, nothing acts as safeguards for a company when good governance and ethics are back burners. While a single wrongdoing is enough to ruin the reputation of a company, it takes ages to build the culture of strict adherence to good governance practices keeps it ahead on sustainable basis.

While the goal of achieving monetary gains is laudable, the means to achieve that end are as meaningful as the end itself. This makes it imperative for professionals to ensure that companies means do not trespass the moral and ethical boundaries, besides the legal limitations.

In a world of exponentially shortening product and service life cycles, professions have to continuously innovate – redefine – recreate – think out of the box. The future winners will be those firms that escape from the gravitational pull of the past on the fuel of innovation.

Globalisation of Professional Services

Pre-Uruguay Round GATT framework applies only to trade in goods, reflecting traditional assumptions that services are not easily tradable. The splintering of services from goods and increasing use of external contracting to obtain service inputs into the production of goods have

created new explicit markets for services. As the comparative advantage in the production of many manufactured goods has shifted to new industrialising countries, the developed nations have become increasingly concerned with enhancement of trading opportunities in service sector, particularly in the areas such as financial services, insurance, telecommunications, information technology and professional services. In the light of various developments which have created increased potential for international trade in services, the reduction or elimination of barriers to trade in services became a major priority of a number of developed nations at Uruguay Round negotiations and thus, the trade in services has been included in the WTO framework.

General Agreement on Trade in Services (GATS) applies in principle to all service sectors except “services supplied in the exercise of governmental authority”. These are services that are supplied neither on a commercial basis nor in competition with other suppliers’ viz. social security schemes and central banking. The GATS sets out four modes of supply of services. These include cross border trade, consumption abroad, commercial presence and movement of natural persons.

Classification of Professional Services

The WTO Secretariat has divided all services into twelve categories, covering business services, communication services, construction and engineering services, distribution services, education services, environment services, financial services, health services, tourism and travel services, recreation, cultural and sporting services, transportation services and other services.

The professional services covered under Business services, include legal services, Accounting, Auditing and Book keeping services, taxation services etc., but do not include all secretarial services. The services being rendered by Company Secretaries are therefore spread over various sub-sectors such as financial intermediation services and auxiliary services thereof, professional services and computer and related services.

The Mutual Recognition Agreement (MRA) has become the preferred means of resolving issues of professional equivalency and reciprocity in recent years. MRAs vary in scale and scope and can be reached between professional bodies, nations and regional groupings. Their implications for the professions are considerable. In December 1995, at the Bangkok Summit, members of ASEAN signed off on an ASEAN Framework Agreement on Services (AFAS) with the major goals to enhance co-operation in services amongst

Member States in order to improve efficiency and competitiveness, diversify production capacity and supply and distribution of services of their services suppliers within and outside ASEAN; to eliminate substantially restrictions to trade in services amongst Member States; and to liberalise trade in services by expanding the depth and scope of liberalisation beyond those undertaken by Member States under the GATS with the aim to realising a free trade area in services.

A word of healthy caution to the profession here however should not come amiss. We need to be conscious of the fact that all trans-border trade in services through all the modes is intended to be a two way traffic. While there are opportunities for the profession to be looking outwards, there is also the competitive threat of service providers from overseas making inroads into the Indian markets, once GATS becomes fully operational in India. Only cutting edge excellence and constant investment in our own competence profile are the surest ways of insulating our market shares from competitive posturing from abroad, and the time to take proactive action is almost upon us now.

II. BUILDING STRATEGIES FOR FUTURE – KEY CONSIDERATIONS

In view of preceding discussion, it is clear that changes are apace and will continue to impact the corporate and consequently the professions. It is, therefore, imperative that plans and strategies are devised so that the sailing in changing environment becomes comfortable and rewarding. The following paragraphs briefly explain key considerations for building strategies for future :

Professional Preparation

The issue of initial professional preparation, particularly as it concerns matters of accreditation, certification and hence, has been the subject of considerable international attention of late. Accreditation is a form of quality assurance for programmes and institutions; certification formally attests that an individual has met a certain standard of achievement; and licence is the process whereby professionals are granted permission to practise. All three processes vary, sometimes considerably, from country to country and profession to profession. And in all three there is growing support for the idea of greater convergence towards international standards and procedures.

Professional Competencies

Professional competency is another issue that is being addressed internationally. The Australian Institution of

Engineers, for instance, has developed national professional competency standards for engineers that can also be applied to foreign engineers seeking entry. These standards provide a basis for judging the eligibility of candidates for membership, a flexible but rigorous assessment system, the design of undergraduate and postgraduate engineering courses, the development of industry-based competency standards, and the articulation of standards for professional engineers, engineering technologists, and engineering associates. The Hong Kong Association of Accountants is also moving to a competencies-based approach for determining access to the profession by both nationals and foreign-trained accountants.

A variety of professions is addressing the question of whether continuing education should be voluntary or mandatory. In the meantime, professions such as law, accountancy, architecture and engineering are introducing programmes designed to update and expand the knowledge and skills of experienced professionals by making the development programmes compulsory for their members in practice.

Quality of Professional Services

Concerns over quality assurance are, of course, an integral part of international trade in professional services. Quality assurance, indeed, is increasingly being defined in terms of reciprocity and international norms and standards by professional bodies, accreditation agencies, higher education institutions and multilateral and non-governmental organisations.

Professional Ethics

Theodore Roosevelt, twenty-sixth President of the United States, said "To educate a person in mind and not in morals is to educate a menace to society." The National Commission on Fraudulent Financial Reporting (Tread way Commission) indicated that curricula should integrate the development of ethical values with the acquisition of knowledge and skills. John C. Burton, dean of the Columbia University Business School, in a speech to the American Accounting Association, stated that the declining influence of social institutions has increased the role educators must play in shaping values. Cal Thomas made the following assessment: "If we want to produce people who share the values of a democratic culture, they must be taught those values and not be left to acquire them by chance."

The learned professions the world over have accorded highest priority to professional ethical standards in the dealings and relationship of professionals with their

employers, employees, Government, fellow professionals and the public at large. The fundamental principles which should govern the conduct of a professional with others have been broadly identified as to encompass

- Integrity;
- professional independence;
- professional competence;
- objectivity;
- ethical behaviour;
- conformance to technical standards, if any, prescribed; and
- confidentiality of information acquired in the course of professional work.

The standards, principles, codes and best practices evolved in these professions are founded on assumptions of human welfare. The professional is thus expected to owe an allegiance to his calling, which expects him to put his personal interests or that of the company behind those of the professional standards. Therefore, the purpose of ethics in profession is to direct the professionals to abide by a code of conduct that facilitates, if not encourages, public confidence in their services. Now the question is can ethics be taught and the answer is yes, Infact at some point in life, ethics must be taught. The basic values such as honesty, self-control, concern for others, respect for legitimate authority, fidelity, and civility must be passed from one generation to the next, a fundamental process of the family.

One of the universally accepted characteristics of a profession is the observance of a strict code of conduct by the members of the profession. The basic reason why code of conduct is strictly to be enforced in the case of professional is, that a professional is endowed with higher faculties conditioned by an elaborate preparatory education, rigorous instruction and valuable practical training, as to distinguish, above all, righteous act/conduct from those deviant and unedifying.

The services of a professional are personal to a client and the client would, therefore, expect the professional to be a person of character and integrity given by a firm assurance through the code of conduct evolved and effectively administered by the professional body concerned, of which the professional is a member. Code of Conduct which also goes by the synonym 'Professional Ethics' encompasses a professional's conduct towards his peers, the clients, the employer and the public at large.

III. MULTI DISCIPLINARY PARTNERSHIPS – A PATH FOR PROFESSIONALS TO TREAD

One of the most striking changes in the evolution of the American legal market over the last 20 years or so has been the extraordinary growth of mega law firms.

This extraordinary growth has, not surprisingly, caused many law firms to reorganize their governance and management systems to marshal their resources, market their services, and manage their client relationships more effectively. Infact, it has encouraged more business-like behavior in organizations.

The move toward more centralized governance and management systems has also, however, placed increasing pressure on the concept of partnership as the organizing model for large professional firms of the future.

Service providers are now expanding geographically as never before. Their objective is to locate geographical and topical markets that have not been fully penetrated. One of the primary benefits to professionals as one-stop shops, is that they reduce the cost of new market penetration through the cross-selling of new services by professionals who are already in the market-place. This leverage is not available to independent firms, which must undertake significant costs in order to expand into new markets.

The Multi Disciplinary Partnership (MDP) seeks to solve this problem by bringing resources in-house to offer all services to businesses everywhere. The MDP seeks a solution by combining existing networks and service providers into a common organization. Each has the common objective of being global as well as local at the same time.

The MDP can assist all of its members in developing new management skills by sharing information. This can be done at meetings and in publications. Members can meet individually to form sub-groups. These new skills will make each of the members more competitive as well as more competent to provide and manage complex services for their clients.

Cost Effectiveness Through Technology

More than one third of the cost for professional services is overhead including rent, support, equipment and marketing. Technology in recent years has reduced the staff support costs and generally improved productivity. With technology, virtual private networks can be created by anyone. These secure communication links permit direct access from anywhere. New technology also means that operations can be efficiently

managed by making internal documentation easily available without the need for printing and distribution. The Internet can be used to bring the sum total of all the resources of the individual parts of the MDP to each individual professional.

The MDP reduces costs for services while it increases the return to the professional providing the service. The costs are reduced by the elimination of distribution inefficiencies. Professionals deal directly with each other in real time and with their clients. The resources available for each unit are the total resources in the virtual network as a whole rather than the limited resources at the individual member firms.

Competitive Implications

The professional objectives of any for-profit organization are to maintain standards of conduct; offer high-quality, cost-effective services; and compete against the other professionals, who have precisely the same interests, to make the most money. The MDP can make four profound changes on how professional service providers compete.

- Information about clients and professionals can be automatically matched through databases and further refined by the clients and professionals themselves.
- The professionals geometrically expand their referral base because the non-lawyer members are greater in size and are not reluctant to make referrals for fear of losing a client. In addition, the number of clients represented by the MDP is vastly larger than those represented by even the largest law firm network.
- Professionals and clients can be matched according to their interest profiles within an organization. This expands vertically the number of participants if each group is in a different market or provides a different service.
- The MDPs can provide clients access to the same database and tools that members of the relationship enterprise have at their fingertips.

Since professional services, rather than the management of these services, is the profit center for professionals, delegating a portion of "management" to the client would therefore contribute to the bottom line. It would also make the client the marketing vehicle for services, which effectively increases the referral base for each professional.

Therefore, the MDP radically changes the competitive equation making it possible for firms of all

sizes to offer services to their individual clients. It does so at a fraction of the cost of bringing all services in-house and in a way that sets the highest standards both globally and locally.

CONCLUSION

The benefits of knowledge driven society cannot be reaped with traditional thinking. The Company Secretaries have to come to terms with the high expectations of globalisation, financial institutions, investors clients and all the stakeholders of society. Litmus test lies in policies, strategies, processes and practices conforming to the highest global standards. It is not the load that breaks a professional, it is the way he carries it. Ability is what the professionals are capable of doing. Motivation determines what they do. Attitudes determine the altitude to which a professional could reach. It is the attitude and not the aptitude that determines the altitude of a person. The success of a professional depends on his attitude. All limits are self-imposed. We must not be complacent with doing what every one else is doing we need to do better than others. We need major breakthroughs in all new and emerging areas and for that we must go beyond the obvious. Hence, the strategies for future must go beyond the obvious.

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ECONOMIC EFFICIENCY THROUGH COMPETITION LAW: A CASE FOR GLOBALISATION OF INDIA INC.

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1. INTRODUCTION

A free enterprise economy implies competition as a great regulative force which establishes control over economic activities and market forces. It ensures the “economic salvation” of society. However, a free enterprise economy does not imply unrestrained competition. The extreme Laissez-faire approach of a self-regulating system has been replaced by a recognition that to achieve a substantially more competitive market; reliance must be placed on legal regulation although the scope of regulation is a matter of debate as the term competition is itself vague with its diverse and sometimes conflicting goals. In a more euphemistic language of the Australian Trade Practices Tribunal, competition is a “very rich concept containing within it a number of ideas” and may be valued for many reasons as serving economic, social and political goals.

Rudoff Callmann developed the metaphor of Competition as a “order of struggle”, The Antitrust laws are concerned with defining the fundamentals of the competitive order and preventing “peace” in the competitive process:” ... just as the law of the order of peace is violated by struggle so the law of struggle is violated by peace”.

In fact, the idea of competition has had, for two centuries or more, a powerful influence on the way we think about our society, the way we organise things and the way we conduct our own economic and personal lives. There is, however, little agreement on what competition really entails. However, competition is an essential element in the efficient working of markets. It encourages enterprise efficiency and widens choice. It enables consumers to buy the goods they want at the best possible price. By encouraging efficiency in industry, competition in the domestic market-whether between domestic firms alone or between those and overseas firms-also contribute to international competitiveness.

Competition and Economic Efficiency

A number of empirical studies found a positive relationship between competition and innovation, productivity and economic growth. Aghion and Howitt (1998) offered several theoretical situations where competition is conducive to innovation – Intensified product market competition could force managers to speed up the adoption of new technologies; Intensive product market competition with incumbent firms engaged in step by step innovative activities could increase each firms incentive to acquire or increase its technological lead over its rivals and if labour markets are flexible, competition will induce skilled workers to move to opportunities employing best practices and technologies.

The competition also reduces slack by providing more incentives for managers and workers to increase efforts and improve efficiency. Therefore, the product market competition disciplines firms into efficient operation. Nickel et.al. (1997) suggested three different channels of incentives – competition creates greater opportunities for comparing performance; a more competitive environment where price elasticity of demand tends to be higher, induces greater efforts among workers and managers for cost reducing improvements in productivity since improvements could generate larger increase in revenue and profits; and a more competitive environment forces managers to improve efficiency, because more intense the competition, greater the chances for inefficient to be extinguished.

Competition Law — A Tool for Enhancing Competition

The Competition Law is an important tool for encouraging competition and market efficiency. The competition law generally aims at preventing or remedying business actions that constrain market forces, cause economic harm and weaken economic

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performance. It prevents economic agents in the market from distorting the competitive process through various kinds of anti competitive behaviour, such as cartels or vertical restraints, which can not be spontaneously corrected through market mechanism within a reasonable time.

The majority of contemporary competition laws treat agreements to fix prices, limit output, rig bids or divide markets very harshly and those agreements are prohibited *per se* illegal. However, the rule of reason is generally applied in the case of vertical restraints and the pro and anti competitive efforts are balanced on a case to case basis. The merger control which is another important component of competition law, prevents the creation of undertakings that will have the ability to exercise market power.

In this backdrop and keeping in view the global ambitions of Indian companies, it becomes imperative for professionals advising Indian companies to realize their global ambitions that they have a clear and unambiguous, understanding of competition laws as well as practices and procedures being followed by competition institutions in various countries. In this

article, therefore an attempt has been made to provide initiatives for reforms in competition law in various countries, summary of competition law of select countries and the comparative rating of various competition authorities on a defined scale.

2. NEW INITIATIVES FOR REFORMS IN COMPETITION LAW - GLOBAL PERSPECTIVE

In view of globalisation of markets and market oriented policies, the Governments the worldover have taken initiatives either to enact new legislation on competition or tailor the existing ones to suit the changing market conditions. It is evident from the fact that the number of countries adopting a competition law and policy went up steeply during the decade of 1990s, when most developing countries adopted open market policies and a period which witnessed the establishment of the WTO. The number of countries with competition regime was 90 in the year 2003 as against 35 in 1995 and the number is growing. Following table shows various stages of preparation in the countries which are considering a new competition law :

STATUS OF NEW COMPETITION LAW IN VARIOUS COUNTRIES	STATUS
Bangladesh, Bahamas, Belize, Cambodia, Congo, Guyana, Laos, Surinam, Trinidad and Tobago	*
Algeria, Antigua and Barbados, Angola, Azerbaijan, Botswana, Burkina Faso, Dominica, Egypt, Ghana, Grenada, Jordan, Mali, Montserrat, Morocco, Namibia, Nepal, Pakistan#, Philippines, Senegal, St. Kitts and Nevis, St. Lucia, Swaziland, Togo, Turkmenistan, Vietnam	**
St. Vincent and Grenadines	***
India, Malawi, Sri Lanka#, Thailand#	****
<p>* Initial discussions/drafting;</p> <p>** Draft law is ready, discussions are on;</p> <p>*** Law has been enacted, implementation awaited;</p> <p>**** Implementation has started.</p> <p># Old Law is being/has been replaced</p> <p>Source : Reguletter No. 13 published by CUTS Centre for Competition, Investment & Economic Regulation (2003)</p>	

3. REFORMS IN COMPETITION LAW - INDIAN PERSPECTIVE

Legal framework dealing with competition in India spread over various legislations, besides the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act) which is the principal legislation dealing with Monopolistic and Unfair Trade Practices since 1969. Other legislations include Consumer Protection Act, 1986, Prevention of Food Adulteration Act, 1954, Standards of Weights & Measures Act, 1976, Packaged Commodities Rules, 1977, Patents Act, 1970, the Customs Tariff (Amendment) Act, 1995 and SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 1997.

Subsequently, the need for fostering competition in Indian Markets was felt with the introduction of new Industrial Policy, 1991, that led to the amendment in existing Monopolies and Restrictive Trade Practices Act, 1969. In the year 1999 the Hon'ble Finance Minister in his budget speech for the year 1999-2000 said that "The Monopolies and Restrictive Trade Practices Act has become obsolete in certain areas in the light of international economic developments relating to competition laws. We need to shift our focus from curbing monopolies to promoting competition". As a follow up the process of enacting a new competition law had been expedited with the setting up of a committee to examine the provisions of the Monopolies and Restrictive Trade Practices Act, 1969 and to propose a modern competition law.

The terms of reference required the committee to recommend—

- (i) a suitable legislative framework, in the light of international economic developments and the need to promote competition, relating to competition law, including law relating to mergers and demergers, such a legislative framework could entail a new law or appropriate amendments to the MRTP Act, 1969;
- (ii) Changes relating to legal provisions in respect of restrictive trade practices after reviewing the existing provisions and ensuring clear demarcation between the jurisdiction of the MRTP Commission and the consumer courts under the Consumer Protection Act, 1986 so as to avoid overlapping of jurisdiction; and
- (iii) Suitable administrative measures in order to implement the proposed recommendations

including restructuring the MRTP Commission and the location of Benches outside Delhi for expeditious disposal of cases pending before the Commission.

The Committee submitted its report to the Government in May 2000, recommending enactment of a competition law to prohibit practices having appreciable adverse effect on competition, such as, anti competitive agreements between enterprises; abuse of dominance; and undesirable combinations i.e. mergers/acquisitions and amalgamations of a particular size.

The Committee also recommended establishment of a Competition Commission of India to implement the new Act and to take up the Monopolistic and Restrictive Trade Practices cases pending before the MRTP Commission. Committee also recommended the abolition of MRTP Commission and suggested transfer of cases of Unfair Trade Practices to the concerned consumer Courts.

Thus based on the recommendations of the Committee and considering the suggestions of trade, industry, professional bodies and the general public, the Government introduced in the Parliament the Competition Bill, with following main objects :

- to ensure fair competition in India by prohibiting trade practices which cause appreciable adverse effect on competition in markets within India;
- establishment of a quasi-judicial body to be called the Competition Commission of India to undertake competition advocacy for creating awareness and imparting training on competition issues;
- to curb negative aspects of competition;
- investigation by the Director-General of the Commission;
- to empower CCI to levy penalty for contravention of its orders, failure to comply with its directions, making of false statements or omission to furnish material information, etc.
- to create a fund to be called the Competition Fund; and
- to repeal the Monopolies and Restrictive Trade Practices Act, 1969 and the dissolution of the Monopolies and Restrictive Trade Practices Commission.

The Competition Act, 2002 has since been passed by the Parliament to provide, keeping in view the

economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto.

The following provisions of the Competition Act, 2002 have come into effect from March 31, 2003, namely — Short title, extent and commencement (section 1); Definitions of Chairperson [Section 2(d)]; Director General [Section 2(g)]; Member [Section 2(j)]; Notification [Section 2(k)]; Person [Section 2(i)]; Prescribed [Section 2(n)]; Composition of Commission (Section 8); Selection of Chairperson and other members (Section 9); Term of office of Chairperson and other members (section 10); Salary etc. of Chairperson and other members (section 14); Appointment of Director General (Section 16); Registrar and Officers of Commission (Section 17); Power to make rules [Section 63(1) and clauses (a), (b), (d), (e), (f) & (g) of Section 63(2)].

4. COMPETITION LAW OF SELECT COUNTRIES

(i) European Communities

The main legislation of the European Communities, which deals with competition, is set out in Articles 85-90 (now Articles 81-86) of the Treaty of Rome. One may find that the similar provisions also exists in the Treaty of Paris, dealing with the products those are covered by the European coal and steel community.

The Competition provisions in the Treaty are primarily Articles 85 and 86 (now Articles 81 and 82). Article 85(1) outlaws agreements or concerted practices which prevent, restrict or distort competition subject to individual and block exemption under Article 85(3), while Article 86 is aimed at abuse of dominant position. In all cases, there is infringement only where trade between member states is affected. All procedural matters are governed by Council of Ministers and Commission Regulations, while block exemption under Article 85(3) (now Article 81) are set out in Commission Regulations adopted from time to time. Since 1990, a number of new competition laws have come into force with the conversion of the socialist economies of Central and Eastern Europe (CEE) to market-based economies. These laws are largely based on the relevant Articles of the Treaty of Rome and have been enacted to create the legal

infrastructure required for supporting a market economy in these countries.

(ii) United Kingdom

The United Kingdom Competition Law comprises of four principal legislations namely, the Fair Trading Act, 1973, the Restrictive Trade Practices Act, 1976, the Resale Prices Act, 1976 and the Competition Act, 1998. The Fair Trading Act deals with mergers and monopolies. The Restrictive Trade Practices Act is concerned with agreements between persons or companies that could limit their freedom to operate independently. The Resale Prices Act covers attempts to impose minimum prices at which goods can be resold. The Competition Act deals with anti-competitive practices, i.e. activities which restrict competition.

These statutes broadly divide into two categories. In the case of Restrictive Trade Practices Act and the Resale Prices Act, action is taken in the courts, while the Fair Trading Act and the Competition Act are wholly administrative and require the examination of any practice by the Director General, the Competition Commission and the Secretary of the State. Under the Restrictive Trade Practices Act and the Resale Prices Act, the Commission has no role and that of the Secretary of the State is limited.

The main provisions of the UK Competition Act, 1998 came into force on 1 March 2000. In general terms, the Competition Act 1998 outlaws any agreements, business practices and conduct which have a damaging effect on competition in the United Kingdom. The Act prohibits (i) those agreement between undertakings, decisions by associations of undertakings and concerted practices which prevent, restrict or distort competition, or are intended to do so, and which may affect trade within the United Kingdom; and (ii) the abuse by one or more undertakings of a dominant position in a market which may affect trade within the United Kingdom. It is important to note that certain categories of agreement and conduct are specifically excluded from the scope of the Act.

(iii) United States of America

In USA the major legislations which deal with competition and anti-competitive business conduct include the Sherman Act, the Federal Trade Commission Act, Clayton Act, etc. Antitrust Legislation in USA aimed to the maintenance of open competition as a fundamental principle of the

economic order as a whole. The Sherman Act, said to be of constitutional sweep, aims at arrangements that restrain trade and at monopoly activity. The Act declares all contracts in restraint of inter-state or international trade or commerce as illegal. The Act contains a sweeping condemnation of all monopolies.

The Federal Trade Commission Act condemns "unfair methods of competition" and unfair or deceptive acts or practices. The Clayton Act expands on the general prohibitions of the Sherman Act and addresses anti competitive problems in their incipency. The Act contains specific prohibition against price discrimination, exclusive dealing arrangement, corporate acquisition of stock and interlocking directorates.

In 1936, the Clayton Act's price discrimination prohibitions were detailed and broadened with enactment of the Robinson Patman Act. The Hart-Scott Rodino Antitrust Improvements Act of 1976 seeks to maintain the competition mission and is the responsibility of the Commission alongwith the Department of Justice. Title II of the Act provides the Department of Justice and the Federal Trade Commission with several procedural devices to facilitate enforcement of the anti trust laws with respect to anti competitive mergers and acquisitions.

(iv) Thailand

Over the past few years, business competition in Thailand was being regulated by the Price Fixing and Anti-Monopoly Act, 1979, aimed at protecting the consumers and stimulating competition environment. However, in the year 1999 the Thailand Government enacted the Trade Competition Act, 1999 replacing the Act of 1976. The Trade Competition Act, 1999 is primarily aimed at stimulating competition in the markets to promote economic efficiency and maximise economic welfare. The Act presents a framework for promoting free and fair trade and preventing unfair trade practices, in a competitive environment. The Act applies to all business operations and activities, except the government agencies, state enterprises, co-operatives or groups related to agriculture or farmers and certain business operators prescribed by the Ministerial Regulation.

Section 25 of the Act deals with issues of abuse of dominant position. According to the definition of market domination, the criteria to determine market domination is based on market share and yearly sales volume in the market of certain goods or services.

Section 25 restrains a business operator having market domination from conducting in any of the following manner:

- unreasonably fixing or maintaining purchase or selling prices of goods or services;
- unreasonably fixing compulsory conditions, directly or indirectly, requiring other business operators, who are its customers, to restrict services, production, purchase or distribution of goods or restrict opportunities in purchasing or selling goods, receiving or providing services or obtaining credits from other business operators;
- suspending, reducing or restricting services, production, purchase, distribution, deliveries or importation without justifiable reasons, destroying or causing damage to goods in order to reduce the quantity to be lower than the market demand; and
- intervening in the operation of other business operators without justifiable reason.

Section 26 of the Act prohibits a business operator from carrying out business merger that may result in monopoly or unfair competition, except with the prior permission of Trade, Competition Commission. The major provisions concerning merger of business as contained in Section 26 of the Act include a merger made by a producer with another producer, by a distributor with another distributor, by a producer with a distributor or by a service provider with another service provider, which has the effect of maintaining the status of one business and terminating the status of the other business or creating a new business; and a purchase of the whole or part of the assets or shares of another business with a view to controlling business policies, administration and management.

The business operators meeting or exceeding the prescribed thresholds of merger, are required to obtain the permission of the Trade Competition Commission.

Section 27 dealing with anti-competitive agreements prohibits a business operator from entering into an agreement with another business operator to engage in any act that amounts to monopoly, reduction or restriction of competition in the market of any particular goods or services in the following manner:

- fixing the sales price of goods or services as

- single price, or as agreed, or restrict the sales volume of goods or services;
- fixing the purchase price of goods or services as single price or as agreed or restrict the sale volume of goods or services;
 - fixing an agreement or condition in a collusive manner in order to enable one party to win a bid or tender for the goods or services or in order to prevent one party from participating in a bid or tender for the goods or services;
 - fixing geographical areas in which each business operator may distribute or restrict the distribution of goods or services therein or fixing customers to whom each business operator may sell goods or provide services, to the exclusion of other business operators from competition in the distribution of such goods or services;
 - fixing geographical area in which each business operator may purchase goods or services or fixing persons from whom business operators may purchase goods or services;
 - fixing the quantity of goods or services which each business operator may manufacture, purchase, distribute or provide services with a view to restricting the quantity to be lower than that of market demand;
 - reducing the quality of goods or services to a level below that of previous production, distribution or provision, whether the distribution is made at the same or a higher price;
 - appointing or entrusting any person as a sole distributor or provider of the same category of goods or services; and
 - fixing conditions or procedures in connection with the purchase or distribution of goods or services in order to ensure uniform or agreed practice.

Section 28 of the Act prohibits a business operator who has business relations with business operators outside Thai region, whether on contractual basis or through policies, partnership, shareholding or any other similar form, from carrying out any act because of which a person residing in Thai region, and intending to purchase goods or services for personal consumption, will have restricted opportunities to purchase goods or services directly from business operators outside Thai region. Similarly, Section 29 restrains a business operator from carrying out any

act which is against free and fair competition and has the effect of destroying, impairing, obstructing, impeding or restricting the business operations of other business operators or preventing other persons from carrying out business or causing cessation of their business.

The violation of Sections 25,26,27,28 and 29 has been made punishable with imprisonment of up to 3 years and/or fine of up to six million Baht. Repeated violations have been made liable to double the penalty.

(v) **Zambia**

The Government enacted the Competition and Fair Trading Act, 1994 to suit the changing environment in the wake of privatization of state enterprises and liberalisation owing to structural adjustment programme. The Act aimed at encouraging competition in the economy by prohibiting anti-competitive trade practices; regulating monopolies and concentration of economic power so as to protect consumer welfare; strengthening the efficiency of production and distribution of goods and services; and securing the best possible conditions for the freedom of trade and expansion of entrepreneurship base.

The Act applies to all economic agents in relation to the supply and demand of all goods and services. However, subject to the treaty or agreement to which the state is a party; activities of employees or associations for their own protection; arrangements for collective bargaining on behalf of employers and employees for the purpose of fixing terms and conditions of employment; agreements relating to the use of Intellectual Property Rights; such business or activity as the Minister of Commerce, Trade and Industry may, by statutory instrument, specify.

The act prohibits any category of agreements, decisions and concerted practices aimed at preventing, restricting or distorting competition in the country or any substantial part of it as anti-competitive trade practices. The main elements of the competition law relate to restrictive Trade Practices, Abuse of dominant position, Mergers and Acquisitions. The Act also restrains entities from undertaking acts or behaviour that limit access to the market or otherwise inhibit competition, and which are likely to adversely affect trade or the economy in general.

Restraining the abuse of dominant market position is one of the most important elements of the Act. A firm is said to have a dominant position if it substantially controls business throughout the country or a substantial part of it. This dominant position deemed to be abused if such a firm is engaged in limiting access to markets by other entities or unduly restraining competition or involving in any other act that could adversely affect trade or the economy in general.

The Act prohibits any merger or take-over without prior permission of the Competition Commission. This relates to a merger between two or more independent enterprises engaged in the manufacture or distribution of substantially similar goods or providing substantially similar services; and a take over of one or more such enterprises by another person who controls another such enterprise. Moreover, the Act treats a merger effected abroad by transnational corporations as if the same is completed in India and the stipulations of the Act apply without any discrimination. The Act stipulates a threshold of 50 percent for unilateral and concentrated market share. The following aspects are taken into consideration in arriving at a decision.

- The relevant markets that may be affected by the acquisition;
- Any barriers to entry that may be created;
- Motives and objectives of the concerned parties; and
- The expected effect of the proposed acquisition on competition in relevant market.

(vii) Japan

Japan has been following an active competition policy, focusing on strict enforcement of the Anti-Monopoly Act (Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade) since it was enacted in 1947, with a view to promoting free and fair competition. The Anti-Monopoly Act, 1947 aimed at prohibition of unreasonable restraint of trade; prohibition of private monopolization; and prohibition of unfair trade practices.

Section 3 prohibits horizontal arrangements as unreasonable restraints of trade. The term unreasonable restraint of trade under section 2(6) has been defined as business activities by which

any entrepreneur, by contract, agreement or any other concerted actions, irrespective of its names, with other entrepreneurs, mutually restrict or conduct their business activities in such a manner as to fix, maintain, or increase prices, or to limit production, technology, products, facilities or customers or suppliers, thereby causing, contrary to the public interest, a substantial restraint of competition in any particular field of trade.

Section 19 prohibits conducts, which tend to impede fair competition and are designated as unfair trade practices such as refusal to deal; discriminatory pricing, discriminatory treatment; Tie-in sales; Dealing on exclusive terms; Resale price restriction; and Dealing on restrictive terms.

The Act also prohibits Abuse of Dominant Bargaining Position and declares unlawful for large firms in a dominant bargaining position to use their position to make unreasonable requests to trading partners.

Chapter 4 of the Act stipulates various restrictions on mergers and acquisitions so as to prevent the formation of an anti-competitive market structure. Mergers are prohibited if they may cause a substantial restraint on competition in any particular field of trade. Every company in Japan, which is desirous of becoming a party to a merger, is subject to the prior notification requirements. Since the acquisition of business among companies has the same effect as mergers, the Act treats it in the same manner as mergers. Every company in Japan, which is desirous of acquiring the whole or substantial part of the business of another company in Japan, is subject to the prior notification requirements.

The amendment to Anti Monopoly Act in the year 1999 introduced measures such as introduction or raising of minimum threshold into the notification system for mergers and acquisitions of business and in the reporting system for stockholdings of other companies. A similar amendment was also effected in the year 2001 in respect of corporate divestiture.

The amendment to Anti Monopoly Act in the year 1997 prohibits establishing or transforming into a holding company such a practice constitutes an excessive concentration of economic power. Earlier however, establishing or transforming into a holding company was completely prohibited.

(viii) South Africa

A new Competition Law was enacted in South Africa in October, 1998 and came into force in 1999. It forms an important part of reforms to both address the historical economic structure in South Africa and encourage broad based economic growth. The Act mainly deals with prohibited practices and mergers. The prohibited practices have been classified into restrictive practices, horizontal and vertical; and abuse of dominance.

The Act aims at promoting efficiency, adaptability and development of the economy; providing consumers with competitive prices and product choices; promoting employment and advance the social and economic welfare of South Africans; expanding opportunities for South African participation in world markets and to recognise the role of foreign competition in the Republic; ensuring that small and medium-sized enterprises have an equitable opportunity to participate in the economy; and promoting a greater spread of ownership, in particular to increase the ownership stakes of historically disadvantaged persons.

Chapter 2 of the Act deals with prohibited practices under restrictive practices (horizontal and vertical) and abuse of dominance. The primary test for both restrictive and horizontal practices is whether the practice has the effect of substantially preventing or lessening competition in a market. There are also specific types of horizontal practices that are prohibited per se. These include price-fixing, dividing markets or collusive-tendering. In terms of provisions of the Act abuse of dominance depends on identification of a firm as dominant, based on its market share being at least 45% or a share of between 35% and 45%, provided the firm cannot demonstrate it does not have market power, or a share of less than 35 percent, but where it has market power.

The Act defines market power as being the ability to control prices, exclude competition or behave, to an appreciable extent, independently of competitors, customers or suppliers. The Act also prohibits a series of acts for a firm defined as dominant, such as excessive pricing, refusing access to an essential facility and exclusionary acts.

The Act also provides for compulsory pre-merger notification, subject to the merger being above thresholds set in terms of the assets and/or turnover of the merging entities.

Notifiable mergers are separated into intermediate Mergers and Large Mergers. Intermediate Mergers are those mergers where the combined annual turnover or assets in the Republic of the acquiring firm and the target firm are equal to, or greater than, R50 million and where the assets or turnover of the target firm are greater than R5 million; and Large Mergers include those mergers where the combined annual turnover or assets in the Republic of the acquiring firm and the target firm are equal to, or greater than, R3.5 billion and where the assets or turnover of the target firm are greater than R100 million.

5. RATING THE REGULATORS – GLOBAL COMPETITION REVIEW SURVEY

Global Competition Review Survey for Rating the Regulators the extracts of which were published by the CUTS Centre for Competition Investment & Economic Regulation was conducted during 1999 and the results were collated in the year 2000. The research is based around a 14 points questionnaire sent to thousands of consumers of competition services working in world's major jurisdictions. The survey provides an invaluable picture of what makes a competition and suggests markers by which the global competition community can judge its most powerful members. The survey can be proved to be of immense help to developing countries which are set to create new or to reform their existing competition law as it identified those competition regulators providing exemplary services, so that they could act as benchmarks for other regulators.

The results of the survey have been grouped into following six key areas :

- (i) Satisfaction with the speed of handling of merger cases;
- (ii) Satisfaction with the speed of handling of non-merger cases;
- (iii) Satisfaction with the technical expertise of staff of the authority;
- (iv) Satisfaction with the procedure followed by the authority;
- (v) Satisfaction with the independence of the authority;
- (vi) Satisfaction with the leadership of the Authority.

These key areas were given star ratings that tracked the data as closely as possible in the range of one to five. The Regulators doing a merely adequate job were given a rating of not more than three stars. A table showing the ratings of respective competition authorities is given below :

COMPARATIVE TABLE SHOWING THE RATINGS OF RESPECTIVE COMPETITION AUTHORITIES

SL NO	COUNTRY/ NAME OF REGULATOR	MERGER HANDLING	NON MERGER HANDLING	TECHNICAL EXPERTISE	PROCE-DURE	INDE-PEN-DENCE	LEADER-SHIP
1.	Australian Competition and Consumer Commission	*** 1/2	***	** 1/2	***	** 1/2	**** 1/2
2.	Danish Competition Council	n.a.	**	** 1/2	*** 1/2	***	***1/2
3.	Greek Competition Committee	** 1/2	**	***	*** 1/2	** 1/2	**
4.	French Competition Council	*** 1/2	*	***	***1/2	** 1/2	** 1/2
5.	US Federal Trade Commission	**1/2	* 1/2	***1/2	***	***1/2	****
6.	US Antitrust Division of the Department of Justice	***	** 1/2	***1/2	***1/2	****	****
7.	Belgian Competition Council	***1/2	*	*	** 1/2	****	**
8.	Brazilian Economic Defence Administrative Council	***	***	***	***	*1/2	*****
9.	German Bundeskartellamt	*****	***1/2	***1/2	****	****1/2	***
10.	Japanese Fair Trade Commission	** 1/2	**	**1/2	**1/2	**1/2	**1/2
11.	Swedish Konkurrenssverket	*****	** 1/2	**1/2	***1/2	****1/2	***1/2
12.	Canadian Competition Bureau	**1/2	**1/2	***	***	***	**1/2
13.	European Union Competition Directorate General	****	*	***1/2	***	**	***1/2
14.	Italian Antitrust Authority	***1/2	***	***1/2	***1/2	**	****
15.	Portuguese Directorate General for Trade and Competition	**1/2	*	**	**	*	*1/2
16.	Portuguese Competition Council	**	*	***	**1/2	**	*1/2
17.	New Zealand Commerce Commission	****	***1/2	**1/2	***1/2	***1/2	**1/2
18.	Swiss Competition Commission	****1/2	***	***	***1/2	***1/2	***1/2

BACKGROUND

SL NO	COUNTRY/ NAME OF REGULATOR	MERGER HANDLING	NON MERGER HANDLING	TECHNICAL EXPERTISE	PROCEDURE	INDEPENDENCE	LEADERSHIP
19.	Irish Competition Authority	**	*	***1/2	***	****	***
20.	Israel's Anti Trust Authority	***1/2	**1/2	***1/2	***	****1/2	*****
21.	Competition Authority of The Netherlands	***1/2	**	**	***1/2	****1/2	***
22.	UK-Office of Fair Trading	***	*	***	***	**	***
23.	UK-Competition Commission	***1/2	*1/2	***1/2	**	***1/2	***1/2

A Brief summary of Ratings of Competition Authorities

A brief summary of findings of survey in respect of various competition authorities compiled on the basis of extracts published by CUTS in the year 2001 is given below :

Australian Competition and Consumer Commission (ACCC) : The survey pointed out unusually strong endorsement for the ACCC's speed of handling merger case and thus established its leadership. The ACCC also obtained good scores for security of information and speed in handling non-merger cases. However, in the case of access to third-party complainants, informal guidance and consistency in decision-making the score earned by ACCC remained marginally satisfactory. Additionally dissatisfaction with the ACCC was found concentrated in the areas of transparency, independence, and expertise in handling legal and economic issues.

Denish Competition Council : The survey revealed patchy results for Danish Competition Council as the satisfaction was shown in certain procedural aspects of the authority's work such as ease to gain useful, informal guidance from the agency, and access as a third-party complainant. The survey also pointed out confidence in the authority's ability to keep information secure. However, there were barely satisfactory scores found in respect of independence and legal expertise, a marginally dissatisfactory score for transparency, and a deeply dissatisfactory score for the staff's economic

expertise. A low score for handling of non-merger cases ensured an overall unimpressive rating for the Danish Competition Council.

French Competition Council : The survey revealed a satisfactory rating for the French Competition Council (FCC) in respect of handling merger cases and above average rating in respect of abilities to handle legal and economic issues. FCC has also been rated as a user-friendly and accessible agency in terms of advice and third party complainants. However, its rating remained lower in terms of handling of non-merger cases and dissatisfaction with transparency of decision-making.

Greek Competition Committee : The survey revealed excellent results for Greek Competition Committee (GCC) for ease of access to third party complainants and very good scores for useful informal guidance. The authority's lines of questioning were also found to be highly satisfactory. Similarly, the ratings for procedure were very good, with consistency scoring a particularly high mark. However, the survey revealed low rating in four of the six key areas, dragging down the GCC's overall rating. The score for speed of handling merger cases was just below par while dissatisfaction with speed of non-merger handling and leadership was quite pronounced. Other low scores include those for the authority's independence and its expertise in economic analysis.

US Federal Trade Commission/Anti Trust Division of the Department of Justice : In USA Anti Trust division of Department of Justice and Fair Trade Commission

have parallel jurisdiction to investigate mergers and anti competitive conduct. However, with a view to allocate matters between two agencies, a clearance procedure has been developed to ensure that a case is handled by one agency with great expertise.

The survey revealed spectacular rating for Department of Justice for its ability to keep information secure and for its leadership. Its independence, consistency, ease of access to third party complainants and technical expertise were found to be highly satisfactory. However, the transparency, speed of merger handling and the usefulness of its guidance were judged satisfactory and marked dissatisfaction was found in respect of the speed of non-merger handling and ease of access to informal guidance.

A great deal of satisfaction was revealed in respect of Federal Trade Commission (FTC) leadership, its ability to keep information secure and access to third party complainants. The rating for independence and technical expertise, in particular the ability of the staff to handle economic analysis, were also found to be good. However, consistency earned barely satisfactory result, while transparency was seen as a problem and the speed of merger handling was found to be marginally dissatisfactory with the speed of non-merger handling poor.

Belgian Competition Council : The survey pointed out that the Belgium respondents have little faith in the Belgian Competition Council's ability to handle legal and economic issues or to ask the right kinds of questions. The Council also received extremely low scores for non-merger handling besides showing dissatisfaction with the consistency and transparency.

Brazilian Economic Defence Administration Council : Survey revealed leadership of Brazilian Economic Defence Administration Council, whereas ratings in respect of other key areas were found to be mostly satisfactory. The availability of informal advice and ease of access to third party complainants were highly appreciated but the advice itself was found to be less than satisfactory. Independence registered the greatest dissatisfaction with consistency in decision-making and security of information close behind.

Japanese Fair Trade Commission : The survey revealed greatest frustration with the transparency of Japanese Fair Trade Commission. The survey also pointed out that it is extremely difficult to access the Commission as a third-party complainant. The ratings for handling of both merger and non-merger cases, technical expertise

and independence were found to be low. However, brighter spot include a good score for consistency.

Canadian Competition Bureau : The survey indicated low rating for Canadian Competition Bureau in respect of handling of merger and non-merger cases, transparency and leadership as compared to technical expertise and procedure. The Bureau's informal guidance was found to be useful, and confidence was exhibited in its ability to keep information secure. The satisfactory rating was given to its lines of questioning, expertise in handling legal and economic analysis, accessibility to third party complainants, and independence.

EU Competition Directorate General : The survey revealed great dissatisfaction for EU Competition Directorate General in respect of speed of non-merger handling and criticisms for independence and transparency. However, this was in contrast with satisfactory scores in respect of other key areas where the speed of merger handling was warmly applauded, and leadership was given high marks. The Directorate also received highly satisfactory scores in respect of technical expertise, in particular for the staff's use of economic analysis. The Directorate has received high score for meeting its statutorily defined deadlines in merger review.

Portuguese Director General for trade & Competition and Portuguese Competition Council : The survey revealed unsatisfactory rating for the Portuguese Directorate General with just one exception, i.e., its ability to keep information secure. It registered its lowest score for non-merger handling, with independence almost equally severe. In addition dissatisfaction with the staff's legal and economic expertise as well as its readiness to offer useful, informal guidance were also revealed. On the transparency and consistency front the Directorate General also scored poor Scores and merger handling and effective questioning come closer to being satisfactory.

The Portuguese Competition Council registered modestly satisfactory scores for its expertise in handling legal and economic issues, ability to keep information secure and consistency in decision making. All other areas of the Council's activities received disappointing scores, as it registered lowest score for non-merger handling, and below satisfactory in respect of leadership, independence and transparency.

New Zealand Commerce Commission : The survey revealed highest score for its ability to keep information secure and an excellent result for speed of merger handling and a good score for non-merger handling. In

addition, the survey pointed out that the respondents see the Commission as adequately independent, transparent and consistent in its decision-making. However, low scores for expertise in economic and legal analysis, and a poor for ease of access to informal guidance or making third-party complaints, were received by the Commission.

Swiss Competition Commission : The survey revealed very high scores for Swiss Competition Commission for the speed of handling merger cases and usefulness of its informal guidance. The decision making was found to be fairly consistent and there was also confidence in the staff's legal expertise and in the security of the information. However, only marginal satisfaction was registered in respect of handling of non-merger cases. The score for lines of questioning and expertise in handling economic analysis was unsatisfactory and barely satisfactory for transparency.

Irish Competition Authority : the survey revealed unsatisfactory scores for Irish Competition Authority (ICA) in two key areas, i.e., merger-handling and non-merger handling and highly unsatisfactory score for informal guidance. The ICA however scored extremely good for security of information and expertise in economic analysis. The Authority also received highly satisfactory scores for ease of access and consistency in decision-making and satisfactory in respect of lines of questioning, expertise in handling legal analysis and leadership.

Israel's Anti Trust Authority : The survey revealed a spectacularly high scores for Israel's Anti Trust Authority (IAA) in respect of leadership, independence, speed of merger-handling and legal expertise. IAA also received excellent scores for economic expertise, ease of access for third-party complainants, security of information and consistency. Scores for lines of questioning and transparency were borderline, while speed of non-merger handling was significantly under par. The IAA however received its lowest score for informal guidance.

UK-Office of Fair Trading/Competition Commission : The Office of Fair Trading (OFT) received highest rating for its ability to keep information secure and ease of access to third-party complainants, but satisfactory in respect of leadership, informal guidance and speed of merger handling. The OFT received barely satisfactory results for its staff's technical expertise and consistency but independence and usefulness of informal guidance found wanting. The areas of non-merger-handling and transparency of decision-making, were found to be more problematic.

The UK Competition Commission received its highest scores for independence, effective leadership, technical expertise and keeping information secure. Whereas the score for speed of merger handling and ease of access to third-party complainants remained highly satisfactory. While the consistency of decision-making received a barely satisfactory score, it scored very poor for transparency and informal guidance. The Competition Commission scored lowest for speed of non-merger-handling.

CONCLUSION

It is clear from the preceding discussion that competition is the force that most free market economies rely on to make sure that business enterprises satisfy demands and expectations of consumers. One of the most important changes in competition law enforcement in recent years has been the adjustment made for the gradual globalisation of markets. Additionally, most competition laws around the world prosecute all anti competitive business conduct including mergers and acquisitions to the extent they may adversely affect the competition in the given country. It is, therefore, necessary for professionals advising corporate on spreading their wings to understand the legal framework, technical and procedural mechanism and the practices being followed by the competition authorities.

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STRATEGIES TO MASTER CURRENT INTERNATIONAL SYSTEM AND THE MNC WAY

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Dynamics of trading environment keep on changing very fast. WTO has become the most powerful of multilateral institution responsible for global economic management. There is an extraordinary explosion of both technology and information as well as finance and trade in goods and services. Time and space are reducing in importance. Free trade and free capital mobility are ensuring economic integration of the world.

In this scenario, to assist Indian corporates, the corporate professional needs to acquire knowledge and skills to provide them, especially the Small and Medium Enterprises:

- Access to markets;
- Access to technology;
- Access to finance;
- Access to Skills;
- Help in enhancing transparency in international tax, finance, and trade rules;
- Help in getting special and differential treatment on the lines of developing and least developed countries;
- Help in excluding their products from the operation of certain restrictive trade protection rules viz., anti dumping, anti subsidy, safeguard duty, etc.

While advising corporates in their effort to meet global competition, it is necessary that the corporate professionals gain an understanding of the international financial system and its complications. When dreaming to be a part of a multi-disciplinary framework, Company Secretaries cannot afford to lose sight of current and recent developments in international financial system and need to constantly update themselves on current developments.

This will help them see that the corporate is correctly advised to sail through the turbulence in the international

economic happenings. It would also enable them to help the corporates gain advantage in terms of better financial and economic management.

INTERNATIONAL CRISES

International financial system has faced crisis after crisis. A professional of the future needs to understand and develop the ability to advise corporates to sail through such crises at the global level. As Karl Kaiser, John J Kirton and Joseph P Daniels say in their edit role of "Shaping a New International Financial System—Challenges of Governance in a Globalizing World", Ashgate, the G-8 and Global Governance Series, a core issue concerns the causes of the crisis and contagion and whether it has now been finally concluded. Second core issue is how and how well the international community has coped with the challenges of crisis response and systems strengthening thus far. Is the challenging one of calling for incremental reform, deeper reconstruction, or historic replacement with a very new system of principles, practices, processes, and assets of institutions?

Another core issue focuses on critical defects of the old system and the best design for the new mechanisms to be added in response. We need the best weighting and mix of mechanisms for:

- transparency
- surveillance
- precautionary lending
- international standstill or bankruptcy procedures.

We need to choose the best forms, procedures and sequence of introduction and use for each and we do need to keep on bettering these. We may have to consider moving into broader domains such as control of international financial flows and capital flows, greater exchange rate management, fixity, or even currency unification, and the rules for international liberalization or foreign direct investment.

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We have seen efforts during the last quarter of the 20th century to reform the international financial system, and the role of the G7 in this effort. The world and the G7 confronted as a central challenge the task of altering in basic ways a financial system that was under severe stress. There was the crisis over the global exchange rate regime that served as the very *raison d'être* for the birth of the G7 Summit as an economic institution – the breakdown of the Bretton Woods System of fixed exchange rates in 1971, the failure of the IMF and existing processes to construct a durable, widely accepted alternative and the decisions of the first Summit at Rambouillet, France in 1975 to institute a new system of managed floating. The second was the commercial bank debt crisis precipitated by Mexico's *de facto* default at the IMF meetings in Toronto in 1982, and the work of G7 summits from Versailles in 1982 to Paris in 1989 to arrive finally, in the form of the Brady Plan, at a solution. The third episode, debt relief for the world's poorest countries, began with the "Toronto terms" for relief at the 1998 Summit and continued through to the Cologne debt initiative of 1999.

'CAPITAL' PROBLEMS

In his analysis of the "Asian Crisis and its Implications", Takashi Kiuchi [p.37 of *Shaping a "New International Financial System"*, referred earlier] locates the ultimate causes of the crisis in capital account rather than current account problems, liquidity rather than solvency problems, and the herding behaviour of the investors. He also notes how politicians overriding their officials and regulators compounded the problem. He calls for universal guidelines and processes for accounting disclosure, bankruptcy and financial supervision. Japan's response to the Asian crisis came initially in the form of a proposal for an Asian Monetary Fund that was abandoned in the face of US opposition, then with a "New Miyazawa Initiative" of US \$ 30 billion worth of bilateral lending guarantees, proposals to reform IMF and new measures to make the yen and international currency. According to Kiuchi, the crisis taught us the need for decisive action at the early stages, for enhancing the IMF's authority to deal with capital account problems, and closer regional policy coordination, beginning with macro economic policy and the development of an Asian bond market to replace short-term borrowing from distant bankers. He approves of short term capital restrictions as a transitional measure, mandatory private sector burden sharing and state bankruptcy codes. Above all, he identifies the role of the G7 in moving towards a *de facto* target zone mechanism and points to the benefits that further moves

in this direction could bring. During times of crisis, panicked investors do not distinguish one nation from another in a region. In other words, professional fund managers cannot guide end-investors properly once liberalized financial markets enable far wider participation by amateur investors in speculative emerging markets. Nations within the region have a common stake in preserving investors' confidence. Therefore, the time is ripe for closer regional policy coordination, a process that could begin with the task of macroeconomic policy consultation. Global efforts in this direction deserve further exploration. G7 surveillance and coordination, Kiuchi concludes, should thus be continued, sovereignty over macroeconomic policy has to be compromised considerably in an age of a globalised financial market.

Now, what does the exclusive organisation G7 do for the Newly Industrialized Economies" (NIE's) or in other words, the developing economies of the world? Durican Wood [in his Paper "The G7, International Finance and Developing Countries" presented at Bonn on June 14, 1999, immediately after the meeting of G7 Finance Ministers in Frankfurt, and immediately before the opening of the G7 and G8 Summits themselves in Cologne on 18th June] deals with the issue as follows:

G7 has been an exclusive institution since its inception in 1975. It is an organ representing the interests and policy goals of the seven largest economies in the world. It has a country-club like exclusivity to which those left on the outside can only aspire. The G7 has indeed thrived on such a narrow basis for mutual decision-making! The identification of common interests has been relatively simple, given the similarities of economic development and political systems and the high level of interdependence among its members' economies.

In the 1970's, the exclusive nature of the G7 reflected the dominance of seven states over the global economic system. The same period witnessed a rise in LDC activism with calls for a New International Economic Order (NIEO). By the 1990s, the rise to prominence of several developing country economies, shifts in world trade and competitiveness and the increasing vulnerability of the global financial system and the separation of the G7 from the developing world, in particular from the large emerging markets created, an anachronism.

Witnessing the trebling of the NIE's share of world trade since 1960, the 1988 Toronto G7 Summit concluded that such countries should match their increased economic importance with greater

international responsibilities and a strong mutual interest in improved constructive dialogue and cooperative efforts in the near terms between the industrialized countries and the Asian NIEs, as well as other outward-oriented countries in the region.

From the 1996 Lyon Summit, G7 forwarded the ideal of a new global partnership for development focusing on cooperation, burden sharing, and partnership, of a spirit of common purpose and efficiency.

Such cooperation, however, never materialized. The G7, even taking into account its inclusion of Russia continues to be an exclusive club of the rich. Instead the G7 has attempted to move into the new millennium without the involvement of the largest developing economies. This threatens to pose a serious problem for the Institutions in terms of its effectiveness and its legitimacy as an organ of global governance.

CONTINGENT CREDIT LINE

The two main areas of interest from an LDC perspective concerned the IMF's Contingent Credit Line (CCL) and "bailing in" the private sector in crisis resolution. The CCL was hailed by the G7 Finance Ministers as playing "an important part in crisis prevention". Its goal is to provide a line of credit to countries following sound macroeconomic and structural policies and with reasonable debt structures so that they are protected from contagion during currency and financial crisis. While this seems a positive form of assistance, in the view of some, it actually threatens financial stability by encouraging moral hazard. The argument is simple: if a country following sound policies knows it has access to the CCL, the danger exists that it will be tempted to adopt more risky practices in the knowledge that a bail-out is already available.

In reforming the international financial architecture a major initiative came from the US. The creation of the G22 in 1998 as an adhoc grouping of developed and developing states constituted an attempt to pull together the highly varied experiences of national policy makers. This attached importance to incorporating LDC's into the international financial reform. The G22 formed three working groups that examined the issues of international financial crises, strengthening financial systems, transparency and accountability. Each working group was co-chaired by officials from one developed country and one developing country. Despite this cooperative atmosphere, the G22 did not survive long enough to make a significant contribution to either international financial architecture reform or longer term LDC – G7 cooperation. The group was dissolved after

it had published its reports, with the US deciding that it had served its purpose.

Since 1995, one of the central issues for International Financial Institutions has been increasing transparency and disclosure of information, in particular from LDC governments. The IMF's annual Article IV consultations, developing a core set of accounting standards, and ensuring that private sector firms engage in transparent practices.

But data gathering, says Durican Wood, and transparency are difficult to achieve in LDCs. Many DC governments have a very real interest (usually political) in preventing the truth about their economies from being known. It is difficult to develop standards that are suitable for such widely varying financial systems as, for example, the US and Mexico. Developing standards is one thing, implementing them is yet another.

The overwhelming liberal bias amongst G7 countries and in the IMF's management is pushing them towards the realisation of a classical liberal assumption: that a market will work perfectly under conditions of perfect information.

INTERNATIONAL BANKING

Opportunities to ensure better governance in banking system will continue to arise in future years and company secretaries need to develop strategies to gain an expertise in this financial segment as well if they are to advise Indian entities to face global MNCs. The systemic studies in banking will be more helpful in building strategies for specialist company secretaries of the future.

Following is an example of how banks form the habit of overwhelming overbidding in response to appeal by a Central Bank.

During the period January 1999 to June 2000 the European Central Bank conducted fixed rate tenders. Mr Juan Ayuso and Rafael Repullo in their Paper "Why Did the Banks Overbid? An Empirical Model of The Fixed Rate Tenders of the European Central Bank" [published by Banco de Espana—Servicio de Estudios] test two hypotheses for the overbidding behaviour of the banks in the fixed rate tenders. One hypothesis attributes the overbidding to the expectations of a future tightening of monetary policy, while the other attributes it to the liquidity allotment decisions of the ECB.

The monetary policy instruments used by the ECB are—(i) minimum required reserves, (ii) open market operations, and (iii) standing facilities. The minimum

reserves help to ensure that the euro area banking system has an aggregate liquidity deficit which is covered by two main types of open market operations [selling of securities to mop up excess liquidity and buying of securities to release more liquidity in the system] and the longer term refinancing operations. The refinancing operations can be conducted via fixed rate or variable rate tenders. In fixed rate tenders, the ECB announces the interest rate and the banks bid the amount of liquidity they borrow at this rate. If the aggregate amount of bid exceeds the amount of liquidity the ECB can provide, each bank receives a pro rata share of this liquidity. In variable rate tenders the banks bid the amount they want to borrow and the interest rates they are willing to pay. In this case, bids with successively lower interest rates are accepted until the total liquidity to be allotted is exhausted.

From the beginning of the Monetary Union in January 1999 until June 2000 the main refinancing operations were conducted as fixed rate tenders. A striking feature of these tenders was a very high degree of overbidding by the banks. During May and June 2000 the banks were bidding on average an amount that was more than eight times the size of the consolidated balance sheet of the Eurosystem.

The authors of the Paper tested two hypotheses as pointed above to explain the overbidding behaviour by the banks in the fixed rate tenders. The expectations hypothesis attributes overbidding to the expectations of a future tightening of monetary policy that led the banks to increase their current demand for liquidity in order to reduce the cost of holding reserves over the maintenance period of the reserve requirement. On the other hand, the tight liquidity hypothesis explains the overbidding by the fact that the ECB kept interbank rates over the tender rate, which generated a profit opportunity for the banks that was increasing with the quantity bid.

"Our empirical analysis" the authors explain, "uses two interest rate spreads as explanatory variables: the spread between the one-week Euribor, and the tender rate and the spread between the one-month Euribor and the tender rate. The results show that once we control for the first spread, the effect of the second is small and statistically not different from zero. Hence the evidence supports the view that the reluctance of the ECB to let the interbank rates fall below the tender rate played a crucial role in explaining why the banks overbid.

"The main policy implication of our results is the following. To the extent that overbidding is considered

to be a problem, the ECB should decide the quantity allotted in fixed rate tenders in order to keep the one-week Euribor rate close to the tender rate, instead of computing the allotments from the analysis of the behaviour of the autonomous liquidity creation and absorption factors. However, in the presence of expectations of interest rate changes this alternative policy would probably introduce large variability in the sequence of allotments, which may also be regarded as undesirable."

THE BASEL II

Looking to failures of banks in many countries, the Bank for International Settlements has been grappling with the issue of how much capital a bank should have. The Basel I recommendations on minimum capital requirement were accepted by most countries. Banks in India also proudly indicate in their balance sheets the extent to which they exceed minimum Capital Adequacy Requirement [CAR]. They have adopted the asset classification and provisioning norms prescribed by the Basel Committee as directed by the RBI.

Banks are expected to implement the Basel II norms from 2006. Basel I norms concentrated on credit risks alone and prescribed risk weights for different loan assets essentially on the basis of security available after classifying the assets as standard or non-standard on the basis of payment record. Basel I did not draw a distinction for the purpose of capital allocation between loan assets based on the intrinsic risk in lending to individual counterparties. Security in the form of tangible assets and/or guarantees from the governments/banks is the sole distinguishing factor.

The recommendations put credit extended on secured basis to both a small-scale unit and to a large corporate in the same category for the minimum CAR. The higher probability of default in respect of a loan to a proprietary unit as compared to a large professionally managed corporate did not get reflected in the CAR. Basel II addresses this issue by factoring in the differential risk factor in loans made to different types of businesses, entities, markets, geographies, etc, and allows banks to have different levels of minimum capital taking in to account intrinsic riskiness of exposure.

In Basel II, assets will be risk-weighted based on a rational approach cleared in advance by the regulator and then aggregated to arrive at minimum capital requirement. Higher the risk higher the weightage, and more the capital allocation required. This should make the banks more risk-sensitive. In their lending/investment

activity and derive the benefit from lesser capital requirement for high quality credit risks.

Basel II also recognises operational risks arising out of the day-to-day running of the banks in the form of service quality shortcomings, non-adherence to policy and procedures, staff malfeasances, etc. The capital charge for these is linked to operational income through a multiplier to be given by the regulator based on its of the quality of the banks quality of instructions, style of functioning, control of top management and audit quality.

Company Secretaries can build up skills and expertise in advising banks and the RBI in meeting with and upgrading vis-à-vis Basel II recommendations. In order to master strategies for Indian corporates to meet global giants, it is necessary that Company Secretaries enter through unchartered gates, the financing corridors. This will give them the necessary edge to tackle competition from MNCs in the services field also.

GLOBAL FUNDS

Hindu Business Line of August 22, 2004 reports about feeder funds that may be the next big thing for Indian investors looking for opportunities abroad. The Chairman AMFI is strongly pushing the idea, supported by a few local players of the Mutual Funds industry. The players have already expressed willingness to explore the possibility of developing the right products. Feeder funds will be structured in the domestic market and domiciled in India. Feeder funds will be instrumental in channeling retail investments in to overseas funds. The Indian Union Government had recently opened up the retail investment limit in overseas market to the tune of \$ 25,000. Feeder funds will tap these resources and route retail investments in overseas markets. These funds will take exposure to other investment products, subject to prescribed limits. Feeder funds will whet the appetite of investors who are keen to check out newer, smarter options.. The first is a vehicle, managed by Franklin Templeton, which invests in a US fund dedicated to government securities. The second is an equity fund, offered by IDBI Principal that invests in European, Japanese and US stocks.

It is essential to address the challenge to raise the Indian savings rate from 23-24 per cent to 28-30 per cent range to sustain seven-eight per cent growth rate. Mutual Funds is the way for doing this. The returns from the traditional products provided by banks and post offices have reduced considerably. At the same time, in India, only 6.7 per cent of households own mutual funds as compared to the US where over 49.6 per cent

households own mutual funds. In UK around 17 per cent of households own mutual funds. Unless performance of mutual funds becomes more stable and popular and easy-to-understand mutual fund products are made available to rural and retail households, raising of savings rate in India may not be possible. Company Secretaries need to devise strategies for advising mutual funds in India to do this so that efficiencies in the financial sector in India rise to enable Indian corporates meet the competition form MNC giants.

India, however, is yet to have real estate and commodity funds which local players must provide in the long run.

Company Secretaries who would be rendering professional services to mutual fund industry and commodity exchanges must therefore develop skills in global finance and global financial markets in order to be able to add value to such mutual fund products. Meeting the MNC giants will also require understanding of domestic mutual funds that invest in equities of such giants from abroad.

Company secretaries need to look also at the fact that Indians, and Indian corporates pay about 1.2 per cent more for bank loans and advances than international rates because of the government controls over State-owned banking entities which raise cost of funds and inefficiencies. [Former Planning Commission Member, Mr N K Singh quoted in Hindu Business Line of August 22, 2004]. Company Secretaries can develop skills to help in further reforms in the financial sector to enable Indian companies enhance their competitiveness in order to be able to meet the giants.

HEDGE FUNDS

MNC finances are also propelled by hedge funds known as 'rich man's mutual funds. Other unregistered investment pools, such as venture capital funds, private equity funds and commodity pools are also known as hedge funds. Usually, hedge funds;

- are organized as private investment partnerships or offshore investment corporations;
- use a wide variety of trading strategies involving position-taking in a range of markets;
- employ an assortment of trading techniques and instruments, often including short-selling, derivatives and leverage;
- pay performance fees to their managers; and

- have an investor base comprising wealthy individuals and institutions and relatively high individual investment limit.

Learning to use and advising on hedge fund activity at the international level is another area in which company secretaries need to nurture skills for helping corporates face global competition.

MASTERING MUTUAL FUNDS

Consider that the financial press has chosen to dub 2003 as a remarkable year for the way the mask fell off the face of the American mutual fund industry [Business Standard Fund Manger, Volume VI, No1, August 2004.] Regulators in America clamped down hard on leading US funds for rampant violations and unethical practices. Many heads rolled. Violators had to pay heavy penalties, apart from reimbursing common investors for the losses that accrued to them on account of dubious dealings. The American mutual funds industry has been long considered to be role model for the rest of the world. Funds around the world are now introspecting more about the way they do business and taking corrective action. Back home, one of the biggest ills plaguing the fund industry is called late trading. The deal is to offer preferential treatment to large investors by offering them back-dated Net Asset Values. The offering of the previous day's NAV is bad because, for instance, if the RBI cuts repo rates unexpectedly after close of business hours, it is almost certain that the bond markets would rally the next day. A savvy investor could, thus, negotiate with a mutual fund to accept his application at a stale NAV, so that he gets a share in profits the next day when the market surges. Even though the new applicant's money is not deployed in the markets, and hence does not earn anything consequent to the market rally, the investor gets a share in the gains. Existing investors lose to the extent that their share of gains will come down as the gain is shared by a larger number of investors. In 2003, all income funds recorded daily gains of more than 0.5 per cent. Birla Income Plus—six times, HDFC Income Fund—seven times, Templeton Income Fund—seven times. Medium and long term gilt funds obviously exhibited at least double that figure. The cost to existing investors could have been to the tune of Rs 30 crore if about Rs 1,000 crore of assets were given the benefit of stale NAVs on six crucial days when the NAV gains had been in excess of 0.5 per cent. If one considers the fact that in 2003 the gyrations in gilt funds were sharper than in income funds, a similar amount invested in funds that gained around one per cent, the loss would be Rs 60 crore for the common investors.

One more ill that afflicts the fund industry is unfair allocation of trades. Most mutual funds do not have adequate systems and processes to ensure fair trade allocations. There are no specific regulations governing trade allocations among various trade allocation schemes, although mutual funds are required to maintain records for portfolio transactions relating to each fund scheme. It is not mandatory for funds to mention at the time of purchase or sale of a security the name of the scheme for which the purchase or sale is made. If a fund manager who is responsible to manage three fund schemes wants to place an order with a dealer to buy shares, of, say Power Finance Corporation, he can do so without mentioning the names of the schemes for which he wants to purchase. Dealers effect transactions after the investment officer or fund manager places the order. The latter enjoys the luxury of allocating trades at the end of the day. This leaves scope for manipulation. He can, for example, allocate trades in a manner profitable for the fund schemes that hold promise in terms of asset mobilization.

Mutual fund industry in India is facing crisis of confidence because of over-dependence on corporate funds for building scale. The Fixed Maturity Plans that the funds use for corporates are not made available by them to retail investors. An FMP tries to match the investment horizon of the investor with that of the fund portfolio such that all securities in the portfolio are held to maturity. Since mutual fund investments attract concessional tax rates as against direct investments in securities, these products became hot favourites among corporate investors. The product is custom made to pass the benefit of tax arbitrage to preferred customers. This continues in spite of the fact that there is over-dependence on corporate customers in India. While, in India, only 2 per cent of the households invest in mutual funds as compared to one out of every two households in the USA investing in mutual funds, the catch-the-corporate mindset of Indian mutual fund industry continues. The early strategy was that mutual funds should achieve critical mass by first tapping corporate and institutional funds, raising the required volumes in terms of Assets Under Management and then move on to retail customers. The private sector funds therefore started wooing corporate money. Although institutional money accounts for 75 to 80 percent of some funds' assets, most funds in India are coy about admitting it. Marketing job thus has been easy. The time expended on getting Rs 1 lakh out of a retail investor is far greater than getting a few crores from an institution. There has been truth in the harsh criticism that mutual funds were indulging in unethical practices and launching schemes

that benefited the institutional investors at the cost of the retail investor. Ten years after the entry of private sector mutual funds in India in 1994, industry leaders are in a mood for introspection. The industry has been a witness to a whole lot of unethical practices, including mindless incentivising of distributors, promising assured returns to poorly informed investors and, in some extreme cases, switching investments from scheme to scheme. The culture of numbers has created a rapacious relationship between AMCs and their distributors where one feeds off the other.

Regulatory efforts by SEBI have not helped improve the situation either. During 2002-03, for example, SEBI devised detailed guidelines on corporate governance practices for asset management companies. One of these was the introduction of compulsory benchmarking of a fund's performance against any chosen index. The trustees of funds were also entrusted with the responsibility of reviewing the performance of various schemes against the benchmark index. Everyone including the trustees have been brought under the insider trading regulations. Trustees have now to hold meetings at least once in two months. SEBI has also made it mandatory for the board of trustees to have two-thirds of its strength as independent directors—that is those who are not associates of the sponsors. At the operational level, AMCs have also been asked to put in place risk management systems for fund management, operations and so on.

SEBI has issued guidelines for valuing bond instruments, non-performing assets, and illiquid and unlisted securities. AMFI has mandated funds to follow uniform sector classifications making product comparisons easy for investors. SEBI has also prescribed a code of conduct for mutual fund distributors. But the onus is on fund managements to ensure that their agents and distributors follow the practices laid down in the code of conduct. Yet to hardsell a fund scheme, distributors often share a part of their distribution commission with brokers and retail investors as an incentive. This amounts to promoting and selling schemes for wrong reasons that ends up in misleading the investor. SEBI has put the onus on the fund houses to monitor their distributors and stop incentivising investors. Yet SEBI could go only thus far and no further.

Again, while late trading has been rampant for several years, SEBI took corrective action only recently by introducing uniform cut-off timings for equity and debt funds. It also asked AMCs to set up time stamping machines that would keep track of the date and time when applications were received to curb late trading.

These factors and trends in mutual fund industry pave a great opportunity to carve out a niche service area for better corporate governance in Indian mutual fund industry to enable it to survive and do well in international turbulences.

SERVICE EXPORTS

In a developing country like India, services constitute one of the fastest growing sectors, growing at a rate of more than 8 per cent and contributing to more than 50 per cent of India's GDP. Indian businesses have the greatest opportunity to go global and establish as MNCs in the services sector. Company Secretaries therefore need to nurture expertise and skills in this segment of the Indian corporate sector.

The Foreign Trade Policy announced on 31 August 2004 exempts all goods and services exported from service tax. It also announces an Export Promotion Council for services.

According to a forecast by Nasscom, India's service sector exports are likely to touch \$35 billion by 2007.

The new Foreign Trade Policy has revamped and recast the earlier duty-free entitlement certificate [DFEC] scheme in to "served from India" scheme. The new scheme seeks to create a powerful and unique 'Served from India' brand that is instantly recognised and respected world over. Under the 'Served from India' scheme, individual service providers who earn foreign exchange of at least five lakh and other service providers who earn foreign exchange of at least Rs 10 lakh will be eligible for a duty credit entitlement of 10 per cent of the forex earned by them. Service export promotion council will map opportunities in key services in key markets and develop strategic market access programmes, including brand building in coordination with sectoral players and recognised nodal bodies in the service industry.

The government would also promote establishment of common facility centers for use by home-based service providers, particularly in areas such as engineering and architectural design, multi-media operations, software developers, etc in State and district level towns to draw in a vast multitude of home-based professionals into services export arena.

Considering these initiatives by the Commerce Ministry in Foreign Trade Policy, Company Secretaries can devise strategies to professionally assist Indian service companies meet the global giants and to survive with them.

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BUILDING FUTURE STRATEGIES — ADVISING FOR AUGMENTING INVESTIBLE RESOURCES THE COMMODITY WAY

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In the era of globalization of business and the need to fight with multi national corporations, it is necessary that Indians consolidate their financial strengths and enhance continuously their financial muscle and investible resources. Risks in a globalised business environment are going to be intense and dynamic. The formidability of the challenge of risk management will be graver in this environment. Indians will have to find and learn new ways of protecting against such risks by diversifying their investments and park their savings in safer and fruitful manner. Company Secretaries must show interest in planning strategies to provide financial planning services not only through the stock and derivative markets which are their custom areas. They also need to build future strategies in assimilating expertise in investment in commodities.

The future points to direct commodity investments instead of indirect investment [equity or debt ownership of firms specialising in direct commodity production] as a principal means of obtaining claims on commodity investment. There is increasing evidence that indirect commodity investment, through debt and equity instruments, in commodity-linked firms, does not provide direct exposure to commodity price changes. Recently national and regional commodity exchanges have been made to take shape and become active. As a consequence, investors have one more avenue to invest. In fact MCX, the multi commodity exchange has also entered into an alliance with Singapore commodity exchange providing an opportunity to Indian investors to have international exposure to commodities.

Commodities are assets that have tangible properties. Examples are, bullion, oil, metals, energy, agricultural products, etc. Historically, commodity investments have had a high correlation [tendency to move in tandem] with changes in inflation and a low correlation with returns on stocks and bonds. This is why commodities can be used to effectively hedge against inflation as well as enhance portfolio

diversification. Further, because of increasing global integration of the Indian economy, domestic Indian commodity prices today closely track trends in global price movements. In case of bullion, the correlation is even more striking with even the dollar-euro movement affecting domestic prices.

It is an important factor in asset allocation decisions that in the long run performance of commodities has little correlation with stock and bond markets. Lower correlation will mean that the two sets of investment can go on independently as they are influenced by different sets of factors.

From the point of investors, the historical performance of collateralized investments in commodities suggests that commodities are an attractive asset class to diversify traditional portfolios of stocks and bonds. From January to July of 2004, commodities as a category have significantly outperformed the stock indices in India, They delivered returns of over 10 per cent against a negative equivalent return by the benchmark indices.

Commodity Funds would contribute to the development of the national economy by helping to invest funds fairly and efficiently into the commodity markets. They would encourage a smoother functioning of commodity markets, help better pricing and price discovery. This would translate into more efficient distribution of commodities.

Actually, Indians have traditionally been investing in commodities like gold. The yellow metal is the second best preferred savings/investment vehicle after bank deposits. But today Indian investors have developed a stronger need than before for alternative investment options with potential to deliver better returns. It will therefore be necessary to provide Indian investors access and the ability to invest in commodities. Commodity Funds should fill in the gap as we do not have, as yet, inflation-linked bonds.

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Since national level commodity exchanges are introducing the concept of demat commodity balances and other commodity exchanges are also catching on the idea, the problems of storage, transportation, insurance, etc associated with commodities as asset class will not remain. Managers of commodity funds who invest in various commodity markets would be new financial products that would meet the widening investment needs.

Investors can gain exposure to commodities by investing in commodities or individual commodity futures contracts. Through commodity funds, investors can purchase the units of commodity mutual funds. Investors can place funds with a commodity pool operator [CPO]. A CPO pools all investors' funds together and employs one or more commodity trade advisors [CTA] to manage the pooled funds. Pools have higher minimum investment requirements than public funds. Alternatively, an investor directly retains a CTA to manage his funds on an individual basis. This avenue is open only to investors with substantial net worth and to institutional investors, since CTAs normally set high minimum investment requirements.

CLIMATE EXCHANGES

An ultra-novel concept was introduced from September 7, 2004 in the form of a venture between the Chicago Climate Exchange and London's International Petroleum Exchange to form European Climate Exchange. This will offer European companies a place to trade emissions credits for greenhouse gases. From January 2005, the European Union will put in to effect new rules to curb carbon-dioxide emissions, which contribute to global warming. Companies in the EU's 25 member States will be allowed to emit a certain amount. If they exceed, they can buy credits from companies that have stayed within their limits. The ECX plans to offer trading in emissions-credits futures by the end of 2004, with cash products to follow soon thereafter.

Forward trading has already begun, though not on the ECX. Nine European brokerage houses already facilitate over-the-counter trades. One such firm, "Evolution Markets" estimates that the volume traded has risen from 25,000 tonnes of carbon-dioxide in January 2004 to 600,000 in July 2004. Companies also trade directly with one another. Germany alone produces 800m tonnes a year. In the USA the Chicago Climate Exchange opened last year. Although the Exchange has a list of illustrious corporate clients like Ford, IBM and Dow Corning, trading is very meager for a country that

emits perhaps a quarter of the world's greenhouse gases [quoted in the Economic Times of September 15, 2004 from the Economist]. In the CCX there are lots of sellers but far fewer buyers, so a tonne of carbon-dioxide goes for about \$1, compared with around \$10 in Europe. The reason is that the American market does not have Europe's regulatory shove. The country, unlike Europe, has not signed the Kyoto agreement on climate change and is not forcing companies to limit emissions. The CCX hopes this will one day happen. The CCX also is planning for trading in allowances for sulphur-dioxide emissions, which will cause acid rain. The CCX is pinning hopes on its new European subsidiary. Volume on the ECX is likely to soar as the scheme begins. It is estimated that by 2007, allowances worth upto euro 10 billion will be traded compared with euro 65 million in 2004. While energy companies have the experience of hedging on International Petroleum Exchange and other exchanges, other companies may have trouble adjusting to futures trading. The European Energy Exchange, an electricity specialist based in Leipzig is shortly starting a cash market for carbon-dioxide emissions. Nord Pool, the Nordic Power Exchange, and Austria's energy exchange are also making similar plans.

BACK TO COMMODITIES

Having taken a brief note of innovative developments on the lines of commodity exchanges, let us turn back to the theme of commodity exchanges.

Company Secretaries are well educated and trained in Stock Markets and their nuances. They are trained in derivatives and their mechanisms and utility. These skills and knowledge base can straightaway be used for gaining entry in to and succeeding in providing services to commodity exchanges and their intermediaries, clients, etc.

This diversification into commodities markets by company secretaries may become a future strategy concomitant to the Wealth Management Service growth potential in India. The IBM Business Consulting Services, in its study "Indian Wealth Management and Private Banking Survey 2003-04" states this potential. The study reveals that successful wealth managers with a clear vision and strategy and equipped with supporting people, processes and systems, will reap significant gains. The increased customer demand for sophisticated products will derive wealth managers to offer a wider array of more complex products and services. Technology tools will be critical for both enabling revenue generation as well as achieving operational effectiveness. Increasing deregulation will enable customers to diversify their

wealth locally and globally. As wealth managers, as pointed out in the survey, company secretaries will also need to address staff satisfaction, compensation and retention strategies. Further, they will also have to introduce profitability models and tools to measure and enhance their performance. A foray into the arena of commodity exchanges also needs to be planned if company secretaries were to partake of the growing market for wealth management services.

A commodity is defined as all kinds of goods, i.e., every kind of movable property other than actionable claims, money and securities.

Like a stock exchange, a commodity exchange is an association or a company or any other body corporate organizing futures trading in commodities.

Futures trading is organized in such goods or commodities as are permitted by the Central Government. At present, all goods and products of agriculture (including plantation); mineral and fossil origin are allowed for futures trading under the auspices of commodity exchanges.

REGULATION

Commodities futures contracts and the commodity exchanges organizing trading in such contracts are regulated by the Government of India under the Forwards Contracts (Regulation) Act of 1952 [FCRA], and the Rules framed thereunder.

The nodal agency for such regulation is the Forwards Markets Commission situated at Mumbai. It functions under the aegis of the Ministry of Consumer Affairs, Food and Public Distribution of the Central Government.

So far, due to certain perceptions about commodities markets concerned people of all hues and cries had lost sight of the basic economic function of commodities exchanges, viz, that of price discovery and price risk management. These functions will be separately discussed in this article. The government had therefore imposed prolonged prohibition of futures trading in commodity markets. Recently, it has finally approved futures trading in all commodities through four commodity exchanges leading to national level multi commodity exchange. Having signed WTO agreement and embarked on economic liberalization policies, the government realized the need for futures trading. This is expected to lead to strengthening of competitiveness of India's agricultural products and of the commodities trade and industry.

SIMPLER

Compared to stock markets, commodity markets are not complex. Since the products are natural, they cannot be artificially manipulated. The demand and supply also depends on economic factors. All of us are familiar with commodities in our everyday life and are aware of the ruling prices of commodities. It is therefore easier to understand commodities market. In contrast, as far as stock markets are concerned, most of us are fully aware of the internal affairs of a company.

Actually, in a commodity exchange supply and floating stocks are virtually unlimited. In India, all commodities are under OGL. If somebody tries to corner stocks of particular commodity, to manipulate price, somebody else will import that commodity from any other country. The increased supply will then negate the action of cornering the commodity. In contrast, in stock markets the floating stocks are limited. If an operator buys a large number of shares, prices rise. This does not happen in a commodity exchange. The price of a commodity in a futures market is based on the intrinsic value of the commodity. On a stock market, the price of a scrip may rise or fall by 30-40 per cent even in a single session. This will not happen in a futures exchange in commodities.

SPOT MARKETS

Spot markets are always vibrant everywhere in various commodities. Farmers, industrialists, warehouses, consumers, dealers, and traders buy and sell commodities. A futures exchange does not claim to replace/replicate a spot market. It only supports the spot market players by developing their price risk efficiency by providing hedging tools. The warehousing system that is a constituent of the spot market also takes care of the miniscule delivery tendered in the futures market.

The seller on a commodity exchange guarantees quality to the buyer. He has therefore to take care of storing the commodity to preserve its quality and quantity. Otherwise the buyer may reject the delivery. The buyer also has the option to recheck the quality at the time of delivery.

India already had organized futures trading in other industrial commodities like Aluminium, Copper, Lead and Tin for over a century. But there were no contract for steel futures. The National Multi Commodity Exchange will introduce it for the first time in India. Even London Metals Exchange has tried to introduce a steel futures contract for the last 3 years. The steel

industries worldwide operate through bilateral forwards contract between buyers and sellers. The parties remain anonymous while the exchange acts as a counterparty to both buyers and sellers. A steel user like an automotive manufacturer will be able to use steel futures contract to know the price he would have to pay for raw material when he buys it in the future. At the same time, steel producer can know the price he will receive for his production before the product goes out of his factory by selling a steel futures contract.

MAIN FUNCTION

The main function of a commodities exchange is to provide transparent and liquid contracts markets for its members and customers to use for price discovery, risk management and investment purposes. Farmers, corporations, small business owners, financial service providers, international trading firms and others can manage price, interest rate and exchange rate risk through a process called hedging. This process offsets the price risk inherent in any cash market position by taking an equal but opposite position in the futures market. Hedgers use commodities exchange to protect their businesses from adverse price changes that could have a negative impact on their bottom line.

PRICE DISCOVERY

Futures markets allow speculators to interpret economic data, news and other information and to use that information to make decisions about price and enter the futures market as investors. Speculators bridge the gap between hedgers' bid and offers, thereby making the market more liquid and cost effective. The trading by a diverse group of market participants—all with varying opinions and access to different market information—results in price discovery and provides benchmark prices.

In contrast to physical markets, futures markets trade in futures contracts, which are primarily used for risk management [hedging] on commodity stocks or forward [physical market] purchases and sales. Futures contracts are mostly offset before their maturity. They scarcely end in deliveries. Speculators use them to benefit from changes in prices and are hardly interested in either taking or receiving deliveries of goods.

RISK MANAGEMENT

Since a futures market facilitates offsetting the trades without exchanging physical goods until the expiry of a contract, it attracts hedgers for risk management. It also encourages considerable external competition from those who possess market information and price judgment

to trade as traders in these commodities. There is also a mix of market perception. While hedgers have long term perspective of the market, traders or arbitrageurs prefer an immediate view of the market. Yet all these users participate in buying and selling of commodities based on various domestic and global parameters such as price, demand and supply, climatic and market related information. This leads to efficient price discovery, allowing large numbers of buyers and sellers to trade on the exchange.

Efficiency on commodity exchanges is measured in the following terms:

- The bid-ask spread;
- Direct and indirect costs of trading; and
- Holding such bid-ask positions.

The futures market comprises of farmers, traders, producers, processors, exporters, importers, and industries associated with commodities.

FUTURES CONTRACT

FCRA defines a "forward contract" [futures contract is a type of forward contract] as follows. "A contract for the delivery of goods and which is not a ready delivery contract". A ready delivery contract is defined as one which provides for the delivery of the goods and the payment of price therefor, either immediately or within such period not exceeding 11 days after the date of the contract, subject to such conditions as may be prescribed by the Central Government. A ready delivery contract is required by law to be giving and taking the physical delivery of goods. They are "spot" or "cash" contracts".

Forward contracts are of two types. "Specific Delivery Contracts" and "Futures Contracts". Specific delivery contracts provide for the actual delivery of specific quantities and types of goods during a specific future period. In it the names of both the buyer and the seller are mentioned. By implication, a futures contract is a forward contract, which is not a specific delivery contract. But it is necessarily a contract for the delivery of the goods. A futures contract in which delivery is not intended is void ab initio. It is not permitted for trading at any commodity exchange.

A commodities futures contract is a tradable standardized contract. Its terms are set in advance by the commodity exchange organizing trading in it. The contract is for a specified variety of commodity known as the "basis". Yet quite a few other similar varieties, both inferior and superior, are allowed to be deliverable or tenderable for delivery against the specified futures contract.

The rules and the regulations of the exchange lay down—

- The quality parameters of the “basis”;
- The permissible tenderable varieties;
- The delivery months and schedules;
- The places of delivery;
- The “on” and “off” allowances for the quality differences and the transport costs;
- The tradable lots;
- The modes of price quotes;
- The procedures for regular periodical clearings;
- The payment of prescribed clearing and margin moneys;
- The transaction, clearing and other fees;
- The arbitration, survey and other dispute redressing methods;
- The manner of settlement of outstanding transactions after the last trading day;
- The penalties for non-issuance or non-acceptance of delivery; etc.

The futures market participants have to be members of the commodity exchange or their authorized users. Those who are not members of commodity exchange can trade through the members or their users.

TENDER PERIOD

A contract on a commodity exchange normally has a life cycle of one month. Two weeks before the expiry of a contract, begins the tender period of the contract. As the tender period begins both parties to the contract, both the parties to the contract must state their intentions to give or receive delivery. On that basis, the parties to the contract have to act or to bear the penal charges for any failure in doing so. If a party does not express its intention to give or receive delivery at the beginning of the tender period, it has to square up its open position before the expiry of the contract. If it does not, its position is closed at “due date rate”. This is the process through which a commodity exchange ensures that its transactions have links to the physical market through the delivery process. This also ensures uniformity between spot and futures prices.

At the beginning of the tender period, the sellers intimate to the commodity exchange in order to get

the quality of the delivery certified from empanelled quality certification agencies. They submit documentation to the Exchange giving details of the warehouse within the city where delivery will take place. Sellers are responsible for the goods until the buyers picks up the delivery. Seller receives the money from the exchange against the goods delivered. The payment is effected by the Exchange when the buyer confirms its satisfaction over quality and picks up the delivery in stipulated time.

The buyer has to make payment within three days after the delivery is allotted. The buyer takes delivery from the warehouse at the designated delivery centers on the designated delivery days. If the buyer is at a place different than the place where delivery is being received, brokers help him in handling of delivery, logistic support, quality certification through empanelled agencies and associated billings due to tax implications. In India, commodity exchange has empanelled quality certification agencies like, SGS, Geo Chem, Dr Amins Laboratories, etc.

The client of a buyer-member may use the delivery for his consumption in the industry, or for exports. He may also sell the goods in the spot market or may sell them in the futures market in a subsequent contract, if he is a regular trader.

The parties to the contract are required to negotiate only the quantity to be bought and sold and the price.

PAYMENTS

For effecting electronic payments, members maintain their accounts in a countrywide network of clearing banks like Bank of India, HDFC Bank, IndusInd Bank, Union Bank of India, and UTI bank. All trades on a commodity exchange are supported by an initial margin. The exchange marks-to-market all the open positions at the end of the day. The activity results in either loss or profit on open positions at the end of the day. Those members have booked losses or have losses on open position, make good the shortfalls by making payment to the commodity exchange by next day. The exchange then gives the members who are in profit positions the necessary credits. The commodity exchange processes these payments electronically through its countrywide network of clearing banks.

CONCLUSION

It will thus be observed that, in the context of the new regime under the WTO and e-commerce as well as in view of the emerging need to reduce price risks to

promote competitiveness, the start of functioning of commodity futures market in India is a welcome feature. Company Secretaries are intrinsically capable of providing various kinds of services like risk management, accounting, audit, secretarial audit, assistance in clearing of transactions, exchange management, legal compliances, representation, etc. to ensure good governance of futures markets. They should now come forward and take up the mantle of the commodity futures exchanges.

REGULATION OF INVESTMENTS IN THE NEW ECONOMIC ORDER

V P SHARMA* & M A JOSEPH**

INTRODUCTION

Global economic scenario is changing at a dynamic pace as a result of economic and financial integration of economies. As the process of globalization is gaining momentum, there are simultaneous policy adjustments to attract volumes of foreign direct investment inflows by the participating countries particularly the developing ones. The bulk of FDI flows which originates from developed countries are looking to favourable destinations in the emerging economies. Top 10 industrially and technically most advanced countries still account for as much as 74 per cent of FDI outflows whereas emerging economies like China and India received a meager 8.09% (\$52.7 billion) and 0.52% (\$3.4 billion) respectively of the total FDI outflows in 2002.

The reasons for such miniscule inflow of FDI particularly in India may be attributed to wide and varied preferences of foreign companies but one for sure is lack of policy parameters consistent with changing preferences and investor demands, regulation of investment and the financial systems. It may also be assumed that the inclusion of TRIMs under WTO regime and on going negotiations would require the regulatory framework to be tailored accordingly.

GLOBALISATION

Globalisation means integration of economies, societies, through the cross-country flows of information, ideas, activities, technologies, goods, services, capital and people. The world economy at large has been witnessing an increase in globalization of national economies brought about by a revolution in communication technology and increased liberalization. This is manifest in trade, finance, the application of technology and the location of production.

As globalization integrates markets in goods, services, capital, technology and labour, it can bring new

instability including interest and exchange rate fluctuation and volatile short-term capital flows. It can therefore increase the vulnerability of developing countries. In managing the process of economic and financial integration that is driven by several forces, it is necessary for the public policy to manage the process with a view to maximizing the benefits to its citizens while minimizing the risks. On balance, there appears to be a greater advantage in achieving a well-managed and appropriate integration in to the global process.

Reasons behind the demand for an MAI by industrialised countries

The Multilateral Agreement on Investment (MAI) has remained a debatable issue among developed and developing economies in recent years. The traditional reasons for an MAI by the industrialized countries include the following : (i) They are mainly capital exporting countries. A large share of the global outflows of foreign direct investment emanate from the industrialized countries (ii) They are the home countries of the large Multinational corporations (MNC's) ; (iii) There is rising trend in the volume of FDI flows and their destinations. Although developed countries still absorb among themselves a predominant portion of the global FDI flows, the share of developing countries is rising significantly. Thus, legal security for, and stability of treatment of, FDI in developing countries have become a matter of greater interest to developed countries.

The real reason behind the push of the industrialized countries for an MAI, because of which the MAI being demanded by them focuses more on the issue of the liberalization of inward foreign investment by host countries, is that foreign direct investment is now seen by them as a key 'market access issue'. They see FDI as a crucial ingredient for their enterprises, especially their MNCs, to gain and consolidate market access opportunities around the world, especially in developing

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countries that offer a good market and investment potential. Owing to the advancements in various kinds of technologies, FDI is increasingly becoming more important than trade for delivering goods and services to foreign markets. In addition, it is becoming an important vehicle for MNCs in organizing their production, distribution or functional activities on an international basis to maintain their competitive strength. As far as developing countries are concerned, it must be noted that cross border exports continue to be the principal mode of delivering goods and services to foreign markets.

Moreover integrated international production is increasingly becoming a key element of the operational strategies of MNCs, which means that MNCs look for countries not only for selling their outputs but also for sourcing their inputs, such as for example, supplies of components, parts and even finished items, computer software, and services. Any part of the value chain of a MNC is now potentially open to be located in a country that offers the best advantage for it. According to UNCTAD estimates, nearly one-third of the world trade is intra-firm trade between affiliates of MNCs, while another one-third is between MNCs and non-affiliated enterprises. It is only the balance of about one-third of the world trade, which remains outside the control, or influence of the MNCs.

Therefore, FDI has multiple objectives in seeking market access opportunities around the world: natural resource seeking, market seeking, efficiency seeking, and input or asset seeking, depending on the strategies of the MNCs and the potential offered by the host countries. Multilateral rules, regulations and disciplines on foreign investments, which on the one hand ensure freedom for making the investment and on the other, ensure legal security and stable treatment for the investment made, have therefore become important for the MNCs of the industrialized world.

FOREIGN DIRECT INVESTMENT AND MAI

Foreign direct investment as a key 'market access issue' is therefore also compelling developed countries to push for MAI. FDI being a crucial ingredient for their

enterprises, especially MNCs allows them to gain and consolidate market access opportunities around the world, especially in developing countries that offer a good market and investment potential. Owing to the technological advancements including communications and information technology, FDI is increasingly becoming more important than trade for delivering goods and services to foreign markets. In addition, it is becoming an important vehicle for MNCs in organizing their production, distribution or functional activities on an international basis to maintain their competitive strength.

The last two decades have witnessed a tremendous increase in global FDI flows. This has been accompanied by a slow shift in the pattern of FDI, which has gradually become more favourable to the developing countries. Table 1 presents the percentage of global FDI flows into developed and developing countries and from developed and developing countries in this period. We find that the share of developing countries in total inward FDI has increased steadily. The average annual percentage flow of FDI into developing countries rose from 25 percent in the 1980s to 30 percent in 1990s. This average would have been much higher in the 1990s but for the slow-down of the Asian economies after 1997. The average annual outflow of FDI from developing countries has almost doubled in the 1990s as compared to 1980s though an increasing proportion of FDI flows, i.e., around 88 percent still comes from the developed countries.

Amongst the developing regions, we find that the share of Asian developing countries in the global FDI flows has increased steadily in the last two decades. The average annual inflow of FDI into Asia and Pacific increased to around 54 per cent in the 1980s to around 61% in the 1990s. But the distribution of FDI flows between Asia and Pacific is biased heavily towards the Asian countries. The average annual inflow into Asian countries in the 1980s was around 97 per cent, this further increased to around 99 percent in the 1990s. Within Asia, we find that on an average 72% of total FDI went to South, East and South East Asia in the 1980 and around 97% in 1990's.

TABLE 1

Percentage of Global FDI Inflows and Outflows : 1980-2001

Year	FDI inflows into		FDI outflows from	
	Developed countries	Developing Countries	Developed Countries	Developing Countries
1980	84.68	15.25	93.79	6.17
1981	66.04	33.91	96.08	3.92

BACKGROUND

Year	FDI inflows into		FDI outflows from	
	Developed countries	Developing Countries	Developed Countries	Developing Countries
1982	54.04	45.93	90.20	9.79
1983	65.40	34.53	95.39	4.60
1984	69.44	30.53	95.66	4.32
1985	74.13	25.82	93.15	6.85
1986	81.04	18.97	94.75	5.22
1987	83.37	16.62	95.20	4.80
1988	81.40	18.57	93.24	6.74
1989	84.49	15.26	92.82	7.18
Average	74.40	25.24	94.02	5.96
1990	81.16	18.53	92.82	7.16
1991	70.60	27.71	93.97	6.01
1992	62.67	34.60	87.43	12.53
1993	60.28	36.61	83.69	16.18
1994	55.71	41.86	83.35	16.48
1995	61.51	34.05	85.34	14.46
1996	56.95	39.54	84.15	15.52
1997	56.05	39.96	83.33	15.78
1998	69.73	27.02	92.29	7.35
1999	76.98	20.69	92.70	7.07
2000	82.27	15.95	92.16	7.55
2001	68.44	27.86	93.54	5.89
Average	66.86	30.36	87.79	11.00

Source : UNCTAD 2003.

Within the Asian Developing Countries(Table II), it is interesting to note that there has been a substantial change in the pattern of FDI inflows in the last two decades. China has seen a substantial increase in its average share of total FDI inflows in to this region in

the 1990's..The average share of FDI inflows has also increased in the 1990's for countries like Bagladesh, India, Vietnam ' though their overall share in the 1990's still remain very low.

TABLE 2

Average Share of Countries in Total FDI Inflows and Total FDI Stock in South, East and South East Asia : 1980 to 2001

	Average Share in Total FDI Inflow 1980-1990	Average Share in Total FDI Inflow 1990-2001	Average Share in Total FDI Inward Stock 1980-2001
Bangladesh	0.04	0.08	0.05
China	16.46	40.62	15.35
China, Hong Kong	22.13	16.87	50.96
China, Taiwan	4.73	3.03	2.49
India	1.29	2.07	0.90

BACKGROUND

	<i>Average Share in Total FDI Inflow 1980-1990</i>	<i>Average Share in Total FDI Inflow 1990-2001</i>	<i>Average Share in Total FDI Inward Stock 1980-2001</i>
Indonesia	4.12	2.68	10.23
Korea	3.43	3.98	1.97
Malaysia	14.88	8.18	0.01
Nepal	0.0001	0.0001	0.000
Pakistan	1.11	0.77	0.68
Philippines	1.49	1.90	1.16
Singapore	23.83	11.82	8.49
Sri Lanka	0.62	0.25	0.24
Thailand	5.38	4.84	2.10
Vietnam	0.13	1.59	0.52
Others	0.36	1.32	4.84
Total South, East and South East Asia	100.00	100.00	100.00

Source : Computed from UNCTAD 2003.

FDI continues to expand rapidly, enlarging the role of international production in the world economy. FDI grew by 18 per cent in 2000, faster than other economic aggregates like world production, capital formation and trade, reaching a record \$ 1.3 trillion.

However, in the last two to three years, there have been deceleration in FDI but it does not indicate that the FDI is not important. According to World Investment Report, 2003, global FDI inflows declined in 2002 for the second consecutive year, falling by a fifth to \$651 billion—the lowest level since 1998. Flows declined in 108 of 195 economies. The main factor behind the decline was slow economic growth in most parts of the world and dim prospects for recovery, at least in the short term. Also important were falling stock market valuations, lower corporate profitability, a slowdown in the pace of corporate restructuring in some industries and the winding down of privatization in some countries. A big drop in the value of cross-border mergers and acquisitions (M&As) figured heavily in the overall decline. The number of M&As fell from a high of 7,894 cases in 2000 to 4,493 cases in 2002—and their average value, from \$145 million in 2000 to \$82 million in 2002. The number of M&A deals worth more than \$1 billion declined from 175 in 2000 to only 81 in 2002—again, the lowest since 1998.

For the multinational corporations (MNCs) most indicators of the size of their foreign operations declined

slightly in 2001 (the latest year for which data are available), the beginning of the FDI downturn. Despite the burst of the bubble in the information and communication technology market, there has been no significant shift in the industrial composition of FDI—nor in the ranking of the world's top 100 MNCs, the top 50 MNCs from developing countries and the top 25 MNCs from Central and Eastern Europe (CEE). The decline in FDI in 2002 was uneven across regions and countries. It was also uneven sectorally: Flows into manufacturing and services declined, while those into the primary sector rose. The equity and intra-company loan components of FDI declined more than reinvested earnings. FDI entering host economies through M&As went down more than that through greenfield projects. Geographically, flows to developed and developing countries each fell by 22% (to \$460 billion and \$162 billion, respectively). Two countries, the United States and the United Kingdom, accounted for half of the decline in the countries with reduced inflows. Among developing regions, Latin America and the Caribbean was hit hard, suffering its third consecutive annual decline in FDI with a fall in inflows of 33% in 2002. Africa registered a decline of 41%; but after adjusting for the exceptional FDI inflows in 2001, there was no decline. FDI in Asia and the Pacific declined the least in the developing world because of China, which with a record inflow of \$53 billion became the world's biggest host country. CEE did the best of all regions, increasing its FDI inflows to a record \$29 billion.

The main developments by region were:

There was a sizable decline in FDI inflows to developed countries, accompanying a continuing slowdown in corporate investment, declining stock prices and a slowdown in the consolidation of activities in some industries—all influenced by weak economic conditions. In several countries, repayments of intra-company loans contributed to lower FDI flows. For instance, a large part of the decline in the United States was due to repayments of loans by foreign affiliates to parent companies, presumably to take advantage of the lower interest rates in the United States as well as for other reasons (such as improving the debt-to-equity ratio of parent firms). The most notable feature of the decline in FDI in the developed countries was the plunge in cross-border M&As, especially in the United States and the United Kingdom. In all, FDI inflows declined in 16 of the 26 developed countries. Australia, Germany, Finland and Japan were among the countries with higher FDI inflows in 2002.

FDI outflows from the developed countries also declined in 2002 to \$600 billion; the fall was concentrated in France, the Netherlands and the United Kingdom. Outflows from Austria, Finland, Greece, Norway, Sweden and the United States increased. In both outflows and inflows Luxembourg headed the list of largest host and home countries (for special reasons).

Africa suffered a dramatic decline in FDI inflows—from \$19 billion in 2001 to \$11 billion in 2002, largely the result of exceptionally high inflows in 2001 (two M&As in South Africa and Morocco, not repeated in 2002). Flows to 23 of the continent's 53 countries declined. FDI in the oil industry remained dominant. Angola, Algeria, Chad, Nigeria and Tunisia accounted for more than half the 2002 inflows. Only South African enterprises made significant investments abroad.

The Asia-Pacific region was not spared, either, from the global decline in FDI inflows in 2002. FDI inflows to the region declined for the second consecutive year—from \$107 billion in 2001 to \$95 billion, uneven by sub region, country and industry. All sub regions, except Central Asia and South Asia, received lower FDI flows than in 2001. Flows to 31 of the region's 57 economies declined. However, several countries received significantly higher flows. Intra- regional investment flows, particularly in South-East Asia and North-East Asia, remained strong, partly as a result of the relocation of production activities, expanding regional production networks and continued regional integration efforts. FDI in the electronics industry continued to decline due to

the rationalization of production activities in the region and adjustments to weak global demand. While long-term prospects for an increase in FDI flows to the region remain promising, the short-term outlook is uncertain.

In Latin America and the Caribbean, FDI flows declined for the third consecutive year, from \$84 billion in 2001 to \$56 billion, affecting all sub regions and 28 of the region's 40 economies. Factors specific to the region contributed to this decline, especially the acute economic crisis in Argentina and economic and political uncertainty in some other countries. The services sector was affected most by the decline. Manufacturing FDI proved to be quite resilient, with barely any change, despite the slowdown from the region's major export destination, the United States, and the growing relocation of labour-intensive activities to Asia.

CEE again bucked the global trend by reaching a new high of \$29 billion in FDI inflows, compared to \$25 billion in 2001. That increase masked divergent trends, however, with FDI falling in 10 countries and rising in 9. FDI flows varied across industries as well, with the automobile industry doing quite well, and the electronics industry facing problems. There was also a tendency of firms (including foreign affiliates) in several CEE countries, particularly those slated for accession to the EU, to shed activities based on unskilled labour and to expand into higher value-added activities, taking advantage of the educational level of the local labour force. UNCTAD'S 1999-2001 Inward FDI potential Index, measuring the potential –based on set of structural variables – of countries in attracting FDI, indicates 16 of the 20 leading countries are developed countries and four of them, mature East – Asian Tiger economies. Many industrial, newly industrializing and advanced transition economies are in the *front-runner* category (with high FDI potential and performance) while most poor (or unstable)economies are in the *under performer* category (with both low FDI potential and performance) . Economies in the *above – potential* category (with low FDI potential but strong FDI performance) include Brazil, Kazakhstan and Vietnam. Economies in the *below – potential* category (with high FDI potential but low FDI performance) include Australia, Italy, Japan, Republic of Korea, Taiwan Province of China and the United States.

Flows to the developing countries and developed countries were likely to remain at levels comparable to those in 2002, while those to CEE were likely to continue to rise. In the longer run, beginning with 2004, global flows should rebound and return to an upward trend. The prospects for a future rise depend on factors at the

macro-, micro- and institutional levels. The fundamental economic forces driving FDI growth remain largely unchanged. Intense competition continues to force TNCs to invest in new markets and to seek access to low-cost resources and factors of production. Whether these forces lead to significantly higher FDI in the medium term depends on a recovery in world economic growth and a revival in stock markets, as well as the resurgence of cross-border M&As. Privatization may also be a factor. FDI policies continue to be more favourable, and new bilateral and regional arrangements could provide a better enabling framework for cross-border investment. Findings of surveys of TNCs and investment promotion agencies (IPAs) carried out by UNCTAD and other organizations paint an optimistic picture for the medium term. IPAs in developing countries are far more sanguine than their developed world counterparts. Developing countries are also expected to be more active in outward FDI. IPAs expect greenfield investment to become more important as a mode of entry, especially in developing countries and CEE. Tourism and telecom are expected to lead the recovery.

Government Policies

Government policies are becoming more open, involving more incentives and focused promotion strategies. Facing diminished FDI inflows, many governments accelerated the liberalization of FDI regimes, with 236 of 248 regulatory changes in 70 countries in 2002 facilitating FDI. Asia is one of the most rapidly liberalizing most region. An increasing number of countries, including those in Latin America and the Caribbean, are moving beyond opening to foreign investment to adopting more focused and selective targeting and promotion strategies. Financial incentives and bidding wars for large FDI projects have increased as competition intensified. IPAs, growing apace in recent years, are devoting more resources to targeting Greenfield investors and to mounting after-care services for existing ones.

More countries are concluding bilateral investment treaties (BITs) and double taxation treaties (DTTs), as part of a longer trend, and not solely in response to the FDI downturn. In 2002, 82 BITs were concluded by 76 countries, and 68 DTTs by 64 countries. Many countries are concluding BITs with countries in their own region to promote intra-regional FDI. Asian and Pacific countries, for instance, were party to 45 BITs, including 10 signed with other countries in that region. There has also been an increase in the number of trade and investment agreements. Many recent trade agreements address investment directly—or have indirect

implications for investment, a trend conspicuously different from earlier regional and bilateral trade agreements. The largest number of agreements were concluded by the EU in developed countries mainly involving partners in CEE and Mediterranean countries. For the EU-accession countries of CEE, a policy challenge is to harmonize FDI regimes with EU regulations, with the twin aims of conforming to EU regulations and maximizing the potential benefits from EU instruments, such as regional development funds. Successful adjustment to EU membership in the accession countries will also depend on their ability to establish and develop the institutional framework required to administer and properly channel the variety of funds available from European Community sources for assisting economic development. The non-accession countries face the challenge of updating and modernizing their FDI promotion to optimize the potential benefits being on a “new frontier” for efficiency-seeking FDI—by attracting firms choosing to switch to lower cost locations within CEE.

According to World Investment Report, 2004, over all, UNCTAD is predicting that the share of developing countries in outward FDI can be expected to rise as developing countries become more competitive and their governments permit or even encourage outward FDI—thus further strengthening the “emerging new geography of investment”.

MAIN COMPONENTS OF AN MAI AS ADVOCATED BY INDUSTRIALISED COUNTRIES

The MAI as advocated by the industrialized countries and as evidenced by the mandate and the OECD negotiations have four major components: (a) the liberalization of foreign investment regimes by host countries; (b) fair and equitable treatment of investment; (c) legal security for investment; and (d) effective dispute settlement procedures. Furthermore, the definition of investment for an MAI will be as wide as possible. The OECD-MAI defines investment as “every kind of asset owned or controlled, directly or indirectly, by an investor”, while “investor” means any natural or legal person of a Contracting Party, with the legal person being any kind of entity constituted or organised under the applicable law of a Contracting Party. Such a definition of investment is purposely intended to go far beyond the traditional notion of foreign direct investment (FDI). The definition will cover not only equity investment (regardless of whether it is above or below any specified threshold level), but also portfolio investment, debt capital, monetary and financial transactions, and more importantly, every form of tangible and intangible asset,

including, in particular, intellectual property rights, concessions and licenses. The only exceptions to this broad definition will be trade operations and purely financial transitions in capital and money markets, such as for example, trade credits, traded goods and foreign exchange operations. Needless to say, the definition of investment is key to the scope and ambit of an MAI.

The cornerstone of the MAI being demanded by industrialized countries is the liberalization of the foreign investment regimes of host countries through a legally binding adoption of the principle of non-discriminatory treatment (i.e. the principle of "national treatment") as between domestic and foreign investors. According to a paper circulated at the WTO by the European Union, the purpose of an MAI is to create a "level playing field" for foreign investors around the world so that they are legally assured that they will stand on the same footing as domestic investors when they wish to make an investment in a host country. This principle of non-discriminatory or national treatment is to apply to all stages of an investment, namely, entry, establishment and operation of an investment.

The main elements of the second component of the proposed MAI, namely "fair and equitable treatment of investment" are, (i) national treatment, MFN treatment and transparency in the post establishment phase, (ii) performance requirements, (iii) employment of key personnel, (iv) privatization and (v) monopolies. Of these, performance requirements, privatization and monopolies require specific attention. The OECD-MAI prohibits several performance requirements totally, while some other performance requirements are permitted if they are connected with the grant of fiscal, financial or other advantages by the host country. Among the prohibited performance requirements are: local content requirements, export obligations, hiring a given level of nationals, establishing a joint venture, achieving a minimum level of local equity participation and transfer of technology requirements. It needs to be noted that performance requirements are prohibited even if they apply equally to domestic and foreign investors.

On privatization the OECD-MAI wants to apply the national treatment and MFN principles to all kinds of privatization and all phases of privatization (i.e. to the initial sale of publicly owned assets as well as the subsequent sale of these assets). As regards monopolies, the OECD-MAI does not prohibit the creation of government-designated monopolies, but prescribes that such monopolies observe the rules of non-discrimination in their sales and purchases. Preferential or special

treatment to domestic or nationally owned companies in purchases, for example, will come under prohibition. The only exception to the non-discriminatory treatment is when government procurement is made not with a view to commercial re-sale or use in the further production of goods and services for commercial sale.

The MAI provisions relating to the third component, namely, "legal security for established investment", cover issues such as nationalization and compensation, free transfer of payments, subrogation and protection of existing investments.

On the question of dispute settlement, a critical component of an MAI, what needs to be noted is that the dispute settlement provisions, as indicated in the OECD-MAI, covers not only State to State disputes, but also investor-to State disputes, with the investor having the right to choose the resolution of disputes either through national courts or through international arbitration. The investor will also have the right to choose the rules for arbitration out of ICSID, UNCITRAL or ICC Rules. The arbitral panel in such cases shall be appointed by the Secretary General of the ICSID or the ICC as the case may be. In the case of State to State disputes, the arbitral panel shall be appointed by the Secretary-General, ICSID. At its extreme, an investor can take a State to international arbitration for a host country rejecting his proposal for an investment on the ground of an alleged violation of pre-establishment phase national treatment obligation. It is also worth noting that while an investor can take a State to international arbitration, the State cannot do so. The State can only take recourse to available national legal remedies if it has a dispute with an investor.

Lastly, it is also important to note what OECD-MAI does not contain. It does not address the issue of the obligations of the investors. The general philosophy of the industrialized countries is that an inter-governmental treaty can impose binding obligations only on the signatory States and that corporate behaviour and obligations must be regulated only by national laws and regulations that are applicable alike to both domestic and foreign investors. However, as a sop to trade unions and NGOs, the OECD-MAI incorporates as an Appendix the 1976 OECD 'Guidelines for Multinational Enterprises' (which sets out voluntary standards for the behaviour of such enterprises). The OECD-MAI, however, makes it clear that they are only voluntary guidelines and that their inclusion as an Appendix does not effect the content or character of the MAI itself.

The OECD-MAI does not address the issue of investment incentives or taxation either, although it does address the issue of performance requirements. One of the reasons for this approach is that most investment incentives are tax incentives and that taxation is covered by bilateral tax treaties. This is too complicated a subject to be addressed by an MAI. The OECD-MAI does not concern itself adequately with the environmental issues (which is the reason for environmental lobbies in the West opposing the MAI), except to the extent that the draft permits the stipulation of performance requirements by host countries for environmental reasons. Environmental lobbies have argued that unfettered freedom for foreign investors, as advocated by the OECD-MAI, would limit the ability of host countries, especially developing countries, to safeguard their natural and biological resources, and that therefore, the negotiation of any such MAI should be preceded by a comprehensive environment impact assessment.

On the question of the movement of natural persons, the OECD-MAI has certain provisions on 'key personnel and employment requirements' prohibiting restrictions on the temporary entry, stay and work of individual investors, managers, executives and specialists. These provisions however are subject to the over-riding application of the host country's immigration and labour laws, as well as the professional qualification and certification requirements of the host country. Thus, the supremacy of the immigration, labour and taxation laws of the host country has been kept beyond the pale of the MAI.

MAI – ASIAN PERSPECTIVE

In March 1996, a workshop was organised by the OECD Secretariat in Hong Kong to explain the MAI to 12 selected "dynamic developing countries". Most of them were from the Asian region, including China, India, Malaysia, Indonesia, Korea, Singapore, and Hong Kong. Participants from some key Asian countries were cool and generally unfavourable to the proposed MAI. They raised several concerns and objections on the substance, procedures and institutional context of the proposed rules.

The most interesting feature is that MAI, though initiated by and negotiated amongst OECD countries, is actually intended to be of a global nature, open to all countries to join. Most non-OECD participants were critical of not having been invited to participate in the establishment of the MAI. The chairman of Malaysia's Industrial Development Authority, while observing that "Whatever we say won't affect the process much,"

explained that Asians are sensitive to how they are drawn into a process, and there is considerable discomfort when they are asked to accede to a treaty without being given an opportunity to get directly involved in its shaping. The process could even be seen as objectionable—the equivalent of "accede without representation." He concluded that "If this MAI is intended for global accession, then it has to be a global process, and all countries need to be more directly involved."

The problem has been seen arising from difference of approaches the Western and Asian countries to negotiations. OECD took a top-down approach to the MAI, while the Asia-Pacific region preferred a bottom-up approach. The dynamic growth of the Asia-Pacific region is based on a highly pragmatic approach towards resolving problems and proceeding to the next state. Regarding the OECD proposal, Asian Countries favoured a more evolutionary and not a regulatory approach, and which could be expected to have a negative response to MAI.

Another objectionable point was that the MAI is supposed to achieve a "high standard", and this had been cited as the reason for confining negotiations to OECD countries. The worrisome assumption seemed to be that if non-OECD member countries are to be involved, standards would have been compromised. Since the entry of foreign firms could also have an effect on domestic firms, there is a local concern regarding global liberalization and a domestic dimension to foreign investment. Both aspects had therefore to be considered. The issue "is not investment liberalization per se but the effective and mutually beneficial management of this liberalization".

Asian countries also raised question as to whether the contents of the proposed MAI would be advantageous to developing countries, since the MAI stressed the rights and interests of foreign investors, but had nothing to say on the rights of host countries and the obligation of investors to observe the laws of host countries. One of the representatives of Asian Countries insisted that the protection of a host country's interests and rights and observance of domestic laws should be a crucial part of an investment agreement.

It was generally viewed that foreign investment does play a positive role, each country has a different situation, as they are at different stages of development. Each country has the right to set up its own investment regime based on its own social and economic conditions. Therefore balanced agreement, acceptable to most countries is important. If an agreement is of high

standard but is not acceptable, then it would not be a good or successful one. The MAI should look at the rights of both sides. If only one aspect is stressed, things will go wrong.

World Trade Organisation (WTO) Ministerial Conferences and Regulations of Investments

The establishment of World Trade Organization (WTO) marks a watershed in the international economic and trade relationships. The ambit and jurisdiction of WTO is widening and becoming a virtual forum for perpetual negotiations on newer and newer issues. At the third Ministerial Conference of WTO held at Seattle in November – December, 1999 the industrialized countries tried to push comprehensive agenda for trade negotiations including reduction of industrial tariffs, further liberalization of agricultural trade, multilateral framework of rules on investment, agreement on governments procurement, electronic commerce and improvement in existing WTO agreements from their perspective.

But the ministerial meeting in Seattle turned out to be fiasco. Domestic policies in the United States played a key role in the failure to attain consensus on a broad negotiating agenda, greatly reducing the willingness of the United States administration to agree to put items on table that were opposed by domestic lobbies. Strong differences on the scope of agricultural liberalization between the European Union, on the one hand, and the United States and other agricultural exporters, on the other hand, were also important. Another major factor was the active and full-fledged participation by developing countries, many of which refused to accept the agenda being pushed by a number of high-income countries in some areas most notably the United States on labour standards and raised concern about implementation problems associated with the Uruguay Round. Many also expressed general dissatisfaction concerning the process through which a negotiating agenda was being set. Small countries in particular perceived themselves to be left out completely, not having access to the forum where potential agenda – setting compromises were being crafted.

In the two years following the Seattle ministerial meeting, a great deal of efforts at the WTO was focused on dealing with implementation concerns of developing countries and on building the confidence of the smaller and poorer members in the trading system. Many of the implementation concerns deal with trade and development issues. An important part of confidence-building agenda has been proposals for high income

countries to grant unrestricted market access to the least developed countries.

The Doha Development Agenda that emerged from the 2001 WTO ministerial meeting in Doha, Qatar, launched a broader set of negotiations. The Doha agenda focused prominence to development concerns, reflecting proactive participation by developing countries in the process. Negotiations were to take place on market access for manufacturer, disputes settlement, WTO rules, disciplines on regional integration; environment and trade related Intellectual Property Rights (TRIPs) (geographical indications). These negotiations were to complement the ongoing negotiations on agriculture and services mandated by the Uruguay Round Agreement. The Doha agenda explicitly deals with key concerns of developing countries, including implementation issues from Uruguay Round, the need for technical cooperation and capacity building in developing countries, and the market access for the least developed countries. The meeting also dealt with concerns of developing countries about intellectual property rights and public health. The Doha Ministerial conference also recognized “the case of constructing a multilateral framework to secure transparent, stable and predictable conditions for long term cross border investment, particularly facing foreign direct investment”. They gave the Working Group a new and more ambitious mandate on this subject, and agreed that negotiations on an investment agreement would take place after the next ministerial conference in Cancun on the basis of a decision to be taken, by explicit consensus at that session on the modalities of negotiations.

Since the Doha Ministerial Conference, Working Group has focused on clarifying a number of core issues and what they cover (their scope), transparency, non-discrimination, ways of dealing with commitments on the entry of foreign investment, based on the things members are willing to do rather than general commitment (a “GATS type positive list approach) development provisions ;exceptions and balance of payments safeguards, consultation and dispute settlement. The work of Working Group is guided by number of principles spelled out in Doha Declaration such as the needs to balance the interests of countries where foreign investment originates and where it is invested, countries’ right to regulate investment, development, public interest and individual countries’ specific circumstances. It also emphasizes support and technical cooperation for developing and least developing countries, and coordination with other International organizations such as UNCTAD.

As mandated in Doha, The Fifth Ministerial Conference of WTO was held in Cancun, Mexico, from 10th to 14th September, 2003. The main task of Cancun Conference was to take stock of progress in negotiations and other work under Doha Development Agenda. The conference ended without any agreement on ministerial text. It is the second time in the history of this organization that something like this happens, following the failure of negotiations in Seattle (1999).

However, the Minister's adopted the Ministerial Statement at the end of Conference on 14th September, 2003, which recognized that more work needed to be done to make progress as required under Doha mandates. The Ministerial Revised text took note of the work done by the working group on the Relationship between Trade and Investment as per Doha Ministerial Declaration.

Since the Cancun Ministerial Conference, the G-20 has been continuously coordinating its common approach to the informal consultations by the Chairman General Council. India has also been participating in the meetings of the G-20, both at the Ministerial level and at the official level, in order to secure its interests and to safeguard its concerns in the ongoing negotiations.

FOREIGN INVESTMENT POLICY AND REGULATIONS – NATIONAL PREROGATIVE

The major issue in regard to the MAI or the MIA is not whether foreign investment is good or bad, welcome or un-welcome. The real issue is whether national governments should retain the right and power to establish policy instruments, options and regulations covering investment, including foreign investment.

Most countries presently accept the importance of foreign investment and are trying their best to attract foreign investors. However, there is evidence that foreign investment can have both positive and negative effects. A major objective of development policy is to maximise the positive aspects while minimising the negative, so that, on balance there is a significant benefit. Experience shows that, for foreign investment to play a positive role in economic and social development, governments must have the right and power to regulate its entry as well as the terms and conditions of its operation. The key problem is that the proposed MAI would remove these government rights and powers. By doing so, the negative aspects of unregulated and uncontrolled foreign investment inflow could overwhelm the positive aspects.

Most developing countries now have policies that regulate the entry of foreign firms, and include various

conditions and restrictions governing foreign investment in general and on a sector-by-sector basis. Few countries (if any) have adopted a policy granting total right of entry. In some countries, foreign companies are not allowed to operate in certain sectors, for instance, banking, insurance or telecommunications. In sectors where they are allowed, foreign companies have to apply for permission to establish themselves, and if approval is given it often comes with some conditions.

Of course the mix of conditions varies from country to country. They may include equity restrictions; for example, a foreign company cannot own more than a certain percentage of the equity of the company it would like to set up. There may be ownership restrictions; for instance, foreigners are not allowed to own land or to buy houses below a certain price.

Many developing countries also have policies that favour the growth of local companies. Tax breaks may be available for local companies, but not to foreign firms. Local banks may be given greater scope of business than foreign banks. Local firms may be given preference in the allocation of government business or contracts.

Generally, governments base such policies and conditions on national sovereignty, holding that a country should control at least a significant part of its own economy. Or the policies are justified in the interest of national development, considering that local firms need special treatment at least for a time until they can compete with more powerful and better-endowed foreign companies.

Moreover, most developing countries would argue that during the colonial era, their economies were shaped to the advantage of foreign companies and financial institutions, usually belonging to the colonising country. Local people and enterprises were therefore at a disadvantage, and currently require considerable time and special treatment before they can compete on more balanced or favourable terms with bigger foreign companies. This has been the central rationale for developing countries' policies in applying restrictions or imposing conditions on foreign investments.

The MAI proposes to liberalise foreign investment flows in a comprehensive manner and would therefore have serious consequences. Governments in developing countries would find that the space for adopting their own independent policies regarding investments and foreign companies are very severely restricted. No longer will each government have the freedom to choose its own particular mixture of policies and conditions on foreign investments. The major policies

would be already determined by the multilateral set of investment rules, and the choice available would be very much constrained to more minor aspects

CONCLUSION

Countries conclude international investment agreements at the bilateral, regional and multilateral levels for various reasons. For most host countries, it is mainly to attract FDI. For most home countries, it is mainly to make the regulatory framework for FDI in home countries most transparent, stable, predictable and secure- and to reduce obstacle for future FDI flows. In either case, the regulatory framework for FDI ,at whatever level ,is at best enabling.

For developing countries, the most important challenge in future international agreements is to strike a balance between the potential contribution of such agreements in increasing FDI flows and the preservation of the ability to pursue development- oriented FDI policies that allow them to benefit more from them.- that is ,the right to regulate in the public interest. This requires maintaining sufficient policy space to give government the flexibility to use such policies with in the framework of obligation established to which they are the parties. The tension this creates is obvious. Too much policy space impairs the value of international obligations. Too stringent obligations overly constraint national policy space.

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INTELLECTUAL PROPERTY — ENGINE FOR ECONOMIC GROWTH AND CORPORATE COMPETITIVENESS

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1. INTRODUCTION

The concept of intellectual property is not new as Renaissance northern Italy is thought to be the cradle of the Intellectual Property system. A Venetian Law of 1474 made the first systematic attempt to protect inventions by a form of patent, which granted an exclusive right to an individual for the first time. In the same century, the invention of movable type and the printing press by Johannes Gutenberg around 1450, contributed to the origin of the first copyright system in the world. Towards the end of the 19th century, inventive new ways of manufacture helped trigger large-scale industrialization accompanied by rapid growth of cities, expansion of railway networks, the investment of capital and a growing transoceanic trade. New ideals of industrialism, the emergence of stronger centralized governments, and nationalism led many countries to establish their modern Intellectual Property laws. At the time the International Intellectual Property system also started to take shape with the setting up of the Paris Convention for the Protection of Industrial Property in 1883 and the Berne Convention for the Protection of Literary and Artistic Works in 1886. Therefore, the premise underlying Intellectual Property throughout its history has been that the recognition and rewards associated with ownership of inventions and creative works stimulate further inventive and creative activity that, in turn, stimulates economic growth.

Over a period of time and particularly in contemporary corporate paradigm ideas and knowledge have become an increasingly important part of trade. Most of the value of high technology products and new medicines lies in the amount of invention, innovation, research, design and testing involved. Films, music recordings, books, computer software and on-line services are bought and sold because of the information and creativity they contain, not usually because of the plastic, metal or paper used to make them. Many products that used to be traded as low-technology goods

or commodities now contain a higher proportion of invention and design in their value – for example brand-named clothing or new varieties of plants. Therefore, creators are given the right to prevent others from using their inventions, designs or other creations. These rights are known as intellectual property rights. They take a number of forms, for example book, paintings and films come under copyright; inventions can be patented; brand names and product logos can be registered as trade marks; and so on.

The economic growth and competitiveness of corporations in developed countries can be attributed to fact that they are the producers and exporters of technology and the owner of large part of Intellectual Property rights registered the worldover. The World Development Report, 2002 had estimated that the United States stand to gain \$5.7 billion in net transfers from TRIPs, while Germany, Sweden, and Switzerland were also expected to receive substantial net inward transfers. In contrast, developing countries were expected to experience net outward transfers, amounting to \$430 million for India, \$434 million for Korea, \$481 million for Mexico and \$1.7 billion for Brazil.

The World Development Report, 2002 further pointed out that in developing countries competition laws and policies in general do not address monopoly abuse of Intellectual Property Rights. A survey of competition laws in developing countries indicated that only 5 out of 33 countries prohibit IPR agreements that restrict competition, compared with 9 out of 21 industrial countries. The lack of capacity to enforce competition laws also constrains the ability to control restrictive practices. Unless developing countries rapidly establish adequate competition frameworks and regulatory institutions that also address monopoly abuse of IPRs, it is possible that increasing IPR protection could result in welfare losses from monopoly behaviour. In this context, it is worth mentioning that the Competition Act, 2000 takes care of intellectual property rights.

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Intellectual Property Rights have gained prominence in global economic policymaking over the last one and half decade most notably after establishment of WTO and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) which lays down minimum standards of intellectual property protection to be provided by WTO member countries. In this context developing countries have made a commitment to implement TRIPs. To maximize their net gains, these countries need to take advantage of the flexibility built into TRIPs. There are several areas of flexibility within TRIPs that provide the potential for developing countries to maximize benefits by promoting access to technology and preventing anti-competitive practices. Countries can also use compulsory licensing, allowed by TRIPs under some circumstances, to control anti-competitive behaviour that results from IPRs or in national emergencies, such as public health crisis. The OECD countries have legal provisions for compulsory licensing under some conditions, and many developing countries, including Argentina, Chile, China, Poland, and South Africa, have already introduced such provisions. The United States has granted number of licences under antitrust decrees. In India, the Patents (Amendment) Act, 2002 provides for additional grounds for grant of compulsory licences.

2. ECONOMIC VALUE OF INTELLECTUAL PROPERTY

It is generally agreed that knowledge and inventions have played an important role in economic growth of the countries. It can be seen in the economic development achieved by some countries in the 1990s. Additionally the growing importance of Intellectual Property and the new pattern of global trade provided impetus for forging a connection between Intellectual Property policies and trade law and led to the inclusion of the TRIPS Agreement as one of the agreements in the framework of the multilateral trade negotiations under the Uruguay Round. The influence of importance of Intellectual Property is also reflected in the maximisation of shareholder value by knowledge-intensive industries.

The Intellectual Property assets thus received importance as a measure of corporate viability and future performance. This may be exemplify by the facts that in 1982, some 62 percent of corporate assets in the United States were physical assets, but by 2000, the figure had shrunk to a mere 30 percent. At the beginning of the 1990s, in Europe intangible assets accounted for more than a third of total assets. As early as 1992, in the Netherlands intangible assets accounted

for more than 35 percent of total public and private investments. A recent study shows that, on an average, 40 percent of the value of a company is not shown in any way in its balance sheet. This is perhaps the reason why intellectual property is sometimes referred to as a "hidden value". However, whether hidden or expressly valued, it is now clear that intellectual property – patents, copyrights, trademarks, geographical indications and trade secrets are significant contributors to economic growth and corporate competitiveness.

Intellectual Property indeed is now one of the valuable assets in commercial transactions, be it Intellectual Property licensing, joint ventures, foreign collaborations, manufacturing, purchase or distribution agreements, or mergers and acquisitions. Licenses to use patents, copyrights and trademarks, are often combined with transfers of know-how and are increasingly an important term in technology transactions. These licenses provide royalty revenues to the owner of the Intellectual Property, and distribute products and technologies to licensees who might not otherwise have had access to them. In such transactions, the licensees may also gain rights to create improvements or derivative works and to develop their own Intellectual Property assets, which can then be cross-licensed or licensed to others. This creates a very productive cycle of innovation and invention and add to the revenues of the companies. The Pricewaterhouse Coopers in 1999 found that the global Intellectual Property licensing market totalled more than US\$100 billion, up from US\$50 billion in 1990. Intellectual Property assets are used not only in business transactions, but are also traded in their own right such as online exchanges for the evaluation, buying, selling, and licensing of patents and other forms of Intellectual Property. The buyers and sellers of intellectual property manage their Intellectual Property as financial assets just as investors in stocks, options and other financial instruments.

3. INTERNATIONAL INTELLECTUAL PROPERTY SYSTEM

The International Intellectual Property System is in fact a system of accumulated practices rather than a set of fixed rules. It is the practice of international relations in the matter of legal protection of invention and literary and artistic works, resulting form and governed by both national legislation defining the treatment to be granted to foreigners and international treaties concerning such treatment. It may be emphasised that a country's laws defining the rights of the foreigners form part of the international system even when, the country is not party

to any international treaty on the subject, for such laws form the basis upon which in practice intellectual property is protected in more than one country. There are number of International Treaties/Conventions which deal with the various aspects of intellectual property and industrial property. These Conventions are administered by World Intellectual Property Organisation, popularly known as WIPO.

WORLD INTELLECTUAL PROPERTY ORGANISATION (WIPO)

WIPO is an international organization dedicated to helping to ensure that the rights of creators and owners of intellectual property are protected worldwide and that inventors and authors are, thus, recognized and rewarded for their efforts. This international protection acts as a spur to human creativity, pushing forward the boundaries of science and technology and enriching the world of literature and the arts. By providing a stable environment for the marketing of intellectual property products, WIPO also oils the wheels of international trade. The number of member States belonging to WIPO now stands at 180 reflects the crucial importance and relevance attached to its work.

The roots of the World Intellectual Property Organization go back to the year 1883, when Johannes Brahms was composing his third Symphony, Robert Louis Stevenson was writing *Treasure Island*, and John and Emily Roebling were completing construction of New York's Brooklyn Bridge. In fact, the year 1883 marked the origin of the Paris Convention for the Protection of Industrial Property, the first major international treaty designed to help the people of one country obtain protection in other countries for their intellectual creations in the form of industrial property rights, known as inventions (patents); trademarks; industrial designs. The Paris Convention entered into force in 1884 with 14 member States, which set up an International Bureau to carry out administrative tasks, such as organizing meetings of the member States.

In the year 1886, copyright also entered the international arena with the Berne Convention for the Protection of Literary and Artistic Works with the object to help nationals of its member States obtain international protection of their right to control, and receive payment for, the use of their creative works such as novels, short stories, poems, plays; songs, operas, musicals, sonatas; and drawings, paintings, sculptures, architectural works. The Berne Convention set up an International Bureau to carry out administrative tasks. In 1893, these two bureaux united to form an international organization called the United International

Bureaux for the Protection of Intellectual Property (BIRPI). The BIRPI indeed was the predecessor of the World Intellectual Property Organization

With the growing importance of intellectual property, the structure and form of the Organization also changed and in the year 1974, WIPO became a specialized agency of the United Nations system of organizations, with a mandate to administer intellectual property matters recognized by the member States of the UN.

Even the most well-drafted treaty is powerless without member States to bring its provisions to life, so WIPO actively encourages States to sign its treaties and to enforce them. Widespread accession and consistent enforcement inspire confidence that intellectual property rights will be respected around the world, encourage investment, and contribute to economic development and social well-being. WIPO also initiated a new policy to adapt to rapid changes in the field of industrial property, by using new options to speed up the development of internationally harmonized principles and rules. The adoption of international recommendations on the protection of well-known marks in 1999, on trademark licenses in 2000 and on the protection of marks on the Internet in 2001, complements the traditional and more lengthy treaty-based approach to international legal standard-setting.

WIPO and WTO

WIPO expanded its role and further demonstrated the importance of intellectual property rights in the management of globalized trade in 1996 by entering into a cooperation agreement with the World Trade Organization (WTO). It provides for cooperation concerning the implementation of the TRIPS Agreement, such as notification of laws and regulations and legal-technical assistance and technical cooperation in favor of developing countries. In July 1998 a joint initiative to help developing countries meet their TRIPS obligations in the year 2000 was launched. Assistance continues to be provided post-year 2000 deadline for many developing countries. Special attention will be given to those least-developed countries that need to meet their TRIPS obligations by 2006.

INDUSTRIAL PROPERTY TREATIES ADMINISTERED BY WIPO

WIPO administers 21 treaties and carries out varied program of work, through its member States and secretariat, that seeks to:

- harmonize national intellectual property legislation and procedures,

- provide services for international applications for industrial property rights,
- exchange intellectual property information,
- provide legal and technical assistance to developing and other countries,
- facilitate the resolution of private intellectual property disputes, and
- marshal information technology as a tool for storing, accessing, and using valuable intellectual property information.

LIST OF TREATIES ADMINISTERED BY WIPO

1. Convention Establishing the World Intellectual Property Organization. (Total number of member countries **180** as on March 2, 2004. India is also member of the Convention).
2. Paris Convention for the Protection of Industrial Property. (Total number of member countries **168** as on April 22, 2004. India is member of this Convention)
3. Berne Convention for the Protection of Literary and Artistic Works. (Total number of member countries **155** as on May 6, 2004. India is also member of this Convention)
4. Madrid Agreement for the Repression of False or Deceptive Indications of Source on Goods. (Total number of member countries **34** as on March 18, 2004. India is not a member of this agreement).
5. Madrid Agreement Concerning the International Registration of Marks. (Total number of member countries **74** as on March 17, 2004. India is not a member of this agreement).
6. Hague Agreement Concerning the International Deposit of Industrial Designs. (Total number of member countries **38** as on March 31, 2004. India is not a member of this Agreement).
7. Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks. (Total number of member countries **72** as on January 15, 2004 . India is not a member of this agreement).
8. Lisbon Agreement for the Protection of Appellations of Origin and their International Registration. (Total number of member countries **20** as on January 15, 2004 . India is not a member of this agreement).
9. Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations. (Total number of member countries **77** as on March 4, 2004. India is not a member of this Convention).
10. Locarno Agreement Establishing an International Classification for Industrial Designs (Total number of member countries **44** as on March 23, 2004 . India is not a member of this treaty).
11. Patent Cooperation Treaty. (Total number of member countries **123** as on January 15, 2004. India is a member of this treaty).
12. Strasbourg Agreement Concerning the International Patent Classification . (Total number of member countries **54** as on January 15, 2004. India is not a member of this agreement).
13. Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of Their Phonograms. (Total number of member countries **73** as on April 26, 2004. India is a member of this Convention).
14. Vienna Agreement Establishing an International Classification of the Figurative Elements of Marks. (Total number of member countries **19** as on January 15, 2004. India is not a member of this agreement).
15. Brussels Convention Relating to the Distribution of Programme-Carrying Signals Transmitted by Satellite. (Total number of member countries **24** as on January 15, 2004. India is not a member of this Convention).
16. Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure. (Total number of member countries **59** as on April 15, 2004. India is a member of this treaty).
17. Nairobi Treaty on the Protection of the Olympic Symbol. (Total number of member countries **41** as on January 15, 2004. India is a member of this treaty).
18. Treaty on the International Registration of Audiovisual Works. (Total number of member countries **13** as on January 15, 2004.).
19. Trademark Law Treaty. (Total number of member countries **31** as on January 15, 2004. India is not a member of this treaty).
20. WIPO Copyright Treaty. (Total number of

member countries **46** as on March 24, 2004. India is not a member of this treaty).

21. WIPO Performances and Phonograms Treaty. (Total number of member countries **43** as on February 24, 2004. India is not a member of this treaty.)

4. AGREEMENT ON TRADE RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS (TRIPS)

The WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) is based on the recognition that increasingly the value of goods and services entering the world trade resides in the know how and creativity incorporated into them. The TRIPs Agreement provides for minimum international standards of protection for such know-how and creativity in the area of copyright and related rights, trade marks, patents, geographical indications, industrial designs, layout designs of integrated circuits and undisclosed information. It also contains provisions aimed at the effective enforcement of such intellectual property rights. It provides all member states transitional period so as to enable them to meet these obligations.

Issues Covered under TRIPS Agreement

The TRIPs agreement broadly focuses on following issues -

- How basic principles of the trading system and other international intellectual property agreements should be applied.
- How to give adequate protection to intellectual property rights.
- How countries should enforce those rights adequately in their own territories.
- How to settle disputes on intellectual property between members of the WTO.
- Special transitional agreements during the period when the new system is being introduced.

Principles of TRIPs Agreement

The provisions of WTO Agreement on Trade Related aspects of Intellectual Property Rights are based on the following four principles –

- Minimum level of protection for each of the specified intellectual property rights;
- Effective procedures and remedies for enforcement of intellectual property rights;

- Non-discrimination (National and Most Favoured Nation Treatment); and
- Enforcement through WTO dispute settlement mechanism.

Protection of Intellectual Property under TRIPs

The TRIPs agreement provides for protection of different kinds of intellectual property rights to ensure that adequate standards of protection exist in all member countries. The starting point is the obligations of the main international agreement of the World Intellectual Property Organization (WIPO) that already existed before the WTO was created; namely, the Paris Convention for the Protection of Industrial Property (patents, industrial designs, etc.) and the Berne Convention for the Protection of Literary and Artistic Works (copyright). However, some areas were not covered by these conventions while in some cases, the standards of protection prescribed were thought inadequate. So the TRIPs agreement adds a significant number of new or higher standards for the protection of intellectual property rights.

Enforcement of Intellectual Property Rights under TRIPs

The TRIPs agreement requires the member states to ensure that intellectual property rights are enforced under their laws, and that the penalties for infringement are tough enough to deter further violations. The agreement requires that the procedures must be fair and equitable, and not unnecessarily complicated or costly. They should not entail unreasonable time limits or unwarranted delays. People involved should be able to ask a court to review an administrative decision or to appeal a lower court's ruling.

The agreement describes in some detail how enforcement should be handled, including rules for obtaining evidence, provisional measures, injunctions, damages and other penalties. It says courts should have the right under certain conditions, to order the disposal or destruction of pirated or counterfeit goods. Willful trademark counterfeiting or copyright piracy on a commercial scale should be criminal offences. The agreement further requires the member states to ensure that the owner of intellectual property receives the assistance of customs authorities to prevent imports of counterfeit and pirated goods.

5. DEVELOPMENT OF TRIPS COMPLIANT IPR REGIME IN INDIA

Until recently, the law relating to intellectual property in India were contained in Patents Act, 1970,

Trade and Merchandise Marks Act, 1958, Copyright Act 1957 and Designs Act 1911. India being a member of the WTO, is under obligation to give effect to the various provisions of the TRIPs Agreement of WTO. Although, the process of harmonisation of intellectual property law in India with that of international standards have been undergoing for long. Recently, the Government with a view to meet the time frame provided under TRIPs agreement, expedited this process and amended the Patents Act in the year 1995, 1999 and 2002; and the Copyright Act in the year 1994 and 1999. The Government has also enacted following new legislations in the area of Intellectual Property :

- A. Trade Marks Act, 1999
- B. Designs Act, 2000
- C. Semi Conductor Integrated Circuits Layout Design Act, 2000
- D. The Protection of Plant Varieties and Farmer Rights Act, 2001.
- E. The Geographical indications of Goods (Registration and Protection) Act, 1999

The brief description of above Acts including the Patents Act is given below:

A. Patents Act, 1970

The law relating to patents is contained in the Patents Act, 1970 which has been amended in the year 1999 and 2002 to meet India's obligations under the agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) forming part of the Agreement establishing the World Trade Organisation (WTO). The Patents Act has been amended keeping in view the development of technological capability in India, coupled with the need for integrating the intellectual property system with international practices and intellectual property regimes. The amendment was also aimed at making the Act a modern, harmonised and user-friendly legislation to adequately protect national and public interests while simultaneously meeting India's international obligations under the TRIPs Agreement.

Salient features of Patents (Amendment) Act, 1999

1. Permission for filling of applications for product patent which one intended for use or capable of being used as drug or medicine except the medicine and drugs specified under Section 2(1)(i)(v) of the Patents Act.
2. Grant of exclusive marketing rights for a period

of five years to sell or distribute the article or substance in India.

3. Prescribes certain requirements which both Indian as well as foreign applicants have to satisfy before filing a claim for the grant of exclusive marketing rights in India.
4. Restrictions on applications for patents outside India have been deleted.
5. The provisions of compulsory licensing have been extended to exclusive marketing rights with necessary modifications.
6. Provisions for protecting public interest have been incorporated.
7. Provisions relating to security of India have been incorporated.

Salient features of Patents (Amendment) Act, 2002

1. The definition of invention has been modified confirming to TRIPs agreement and international practices. Therefore, new invention means process or product involving inventive step and capable of industrial application.
2. The term of patent has been extended to twenty years from the date of filing.
3. The time for restoration of ceased patent has been increased from 12 months to 18 months.
4. A request for examination of application has been introduced.
5. The source of geographical origin of the biological material used in the invention to be disclosed in the specification.
6. The applications for patent to be examined in serial order in which the request for examination is filed.
7. Applicant allowed to withdraw application any time before the grant of patent.
8. Grounds of opposition as well as revocation have been enlarged.
9. Provision for allowing Paris Convention Priority have been extended to group or union of countries or inter-governmental organizations.

B. Trade Marks Act, 1999

The Trade Marks Act, 1999 has been enacted to provide for registration of trade mark for good as well as services; prohibition to the registration of imitation of well known trade marks, and expansion of grounds

for refusal of registration. The provisions for defensive registration of trademarks have been omitted; and only a single register with simplified procedure for registration and with equal rights have been provided. The new Act also simplified the procedure for registration of registered user, enlarged the scope of permitted use and allowed the registration of "Collective Marks" owned by associations, etc.

The Act also provides for establishment of an Appellate Board for speedy disposal of appeals and rectification applications, which hitherto lie before High Court. The Act empowers the Registrar to register certification trademarks. So far this power was vested with the Central Government. Provision for enhanced punishment for the offences relating to trade marks on the lines of Copyright Act, 1957; restriction on sale of spurious goods; and use of some one else's trade marks as part of corporate names, or name of business concern have also been made in the Act.

While some of the definitions existed in the Trade and Merchandise Marks Act, 1958 have been made comprehensive and amplified, various new definitions have been inserted in the new Act. The definition of "trade mark" has been enlarged to mean a mark capable of being represented graphically and to include shape of goods, their packaging and combination of colours and covers both goods and services. The definition of "registered trade mark" has been modified to mean a trademark, which is actually on the Register and remaining in force. The definition of "Tribunal" has been modified to include "Appellate Board" in place of "High Court". The existing definition of "High Court" has been deleted consequent to the provision to constitute Appellate Board in lieu of High Court, for appeals.

C. The Geographical Indications Of Goods (Registration and Protection) Act, 1999

Until recently, Geographical indications were not registrable in India and in the absence of statutory protection, Indian geographical indications had been misused by persons outside India to indicate goods not originating from the named locality in India. Therefore with a view to prevent misuse of Indian geographical indications and to extend protection to goods imported from other countries which provide for such protection, the Geographical Indications of Goods (Registration and Protection) Act, 1999, has been enacted.

The new legislation aims at providing for the establishment of Geographical Indications Registry; maintenance of a Register of Geographical Indication

in Part A and Part B containing all registered geographical indications, and particulars of registered authorised users, respectively; registration of geographical indications of goods in specified classes; prohibition of registration of certain geographical indications; compulsory advertisement of all accepted applications; registration of authorised user and providing for infringement action; renewal, rectification and restoration of geographical indications and authorised user; higher level of protection for notified goods; prohibition of assignment and its registration as trademark; effect of registration and rights conferred by registration; offences and penalties; and provision for reciprocity, powers of Registrar and maintenance of Index.

D. The Designs Act, 2000

In view of considerable progress made in the field of science and technology a need was felt to provide more efficient legal system for the protection of industrial designs in order to ensure effective protection to registered designs and to encourage design activity in order to promote the design element in an article of production. In this backdrop, the Designs Act, 2000 has been enacted essentially to balance these interests and to ensure that the law does not unnecessarily extend protection beyond what is necessary to create the required incentive for design activity while removing impediments to the free use of available designs.

E. The Semiconductor Integrated Circuits Layout Designs Act, 2000

Electronics and Information Teleology is one of the fastest growing sectors that has played a significant role in world economy. This is primarily due to the advancements in the field of electronics, computers and telecommunication. Microelectronics, which primarily refers to Integrated Circuits (ICs) ranging from, Small Scale Integration (SSI) to Very Large Scale Integration (VLSI) on a semiconductor chip - has rightly been recognized as a core, strategic technology world-over, especially for Information Technology (IT) based society. Design of integrated circuits requires considerable expertise and effort depending on the complexity. Therefore, protection of Intellectual Property Rights (IPR) embedded in the layout designs is of utmost importance to encourage continued investments in R & D to result in technological advancements in the field of microelectronics.

The practice of providing protection through the methods of Copy Right, Patents did not appropriately accommodate the requirements of Intellectual Property Rights Protection for the Layout-Designs of Integrated

Circuits. This was because in the context of Layout Designs the concept of "originality" is of utmost significance, whether it is a "novelty or not". While the Patent Law requires that the idea should be original as well as novel, the copyright law is too general to accommodate the original ideas of scientific creation of Layout-Designs of Integrated Circuits. In view of the above, the necessity for providing protection for Layout-Designs of Integrated Circuits was felt to reward and encourage an adequate level of investment of human, financial and technological resources.

The Majority of countries that attach significance to protection of Intellectual Property Rights in the Semiconductor Integrated Circuits provides for sui generis system of protection of Layout-Designs of Integrated Circuits, which is usually contained in a separate Act. Trade Related Intellectual Property Rights (TRIPs) Agreement under WTO contains provisions with regard to setting up of standards concerning availability, scope and use of Intellectual Property Rights, Geographical Indications, Layout-Design of Integrated Circuits etc.

Therefore, the Government enacted the Semiconductor Integrated Circuit Layout-Designs Act, 2000 providing for protection of Semiconductor Integrated Circuits Layout-Designs by process of registration, mechanism for distinguishing Layout-Designs which can be protected, rules to prohibit registration of Layout-Designs which are not original and/or which have been commercially exploited, period for protection, provision with regard to infringement, payment of royalty for registered Layout-Design, provisions for dealing with willful infringement by way of punishment, appointing a Registrar for registering the layout designs and mechanism of Appellate Board.

F The Protection Of Plant Varieties And Farmers' Rights Act, 2001

The concept of Plant Breeders' Rights arises from the need to provide incentives to plant breeders engaged in the creative work of research which sustains agricultural progress through returns on investments made in research and to persuade the researcher to share the benefits of his creativity with society.

The issue of enacting a law relating to Plant Varieties Protection and Farmers' Rights in India assumed importance particularly in the wake of TRIPs agreement under WTO which seeks to promote effective protection of Intellectual Property Rights in all fields of technology. Article 27 of TRIPs Agreement defines patentable subject matter and requires member countries to

provide for the protection of plant varieties whether by patenting or by an effective sui generis system or by any combination thereof.

With a view to provide for the establishment of an Authority to give an effective system of protection of the rights of plant breeders and farmers, and to encourage the development of new varieties of plants and to give effect to the provisions of TRIPs Agreement, the Government enacted the Protection of Plant Varieties and Farmers' Right Act, 2001. This Act seeks to stimulate investment for research and development both in the public and private sectors for the development of new plant varieties by ensuring appropriate returns on such investments. It also seeks to facilitate the growth of the seed industry in the country through domestic and foreign investment to ensure the availability of high quality seeds and planting material to Indian farmers. It also recognizes the role of farmers as cultivators and conservers and the contribution of traditional, rural and tribal communities to the country's agro biodiversity by rewarding them for their contribution through benefit sharing and protecting the traditional rights of the farmers. The Act also seeks to set up the Protection of Plant Varieties and Farmer's Rights Authority to promote and develop new varieties of plants and promote rights of the farmers and breeders.

6. INTELLECTUAL PROPERTY MANAGEMENT

In the increasingly knowledge-driven economy, Intellectual Property (IP) is an important key consideration in day-to-day business decisions. New products, brands and creative designs appear almost daily on the market and are the result of continuous human innovation and creativity. Generally, the small and medium companies in India either do not understand the value of their intellectual property assets or are not aware of the intellectual property system or the protection it can provide for their inventions, brands, and designs. As the Intellectual Property forms an important part of companies assets, its adequate protection is crucial in deterring potential infringement and in turning ideas into business assets with a real market value. Infact, the Intellectual Property system enables companies to profit from their innovative capacity and creativity and enhance their competitiveness.

Companies that dedicate time and resources to protecting their intellectual property can increase their competitiveness in a number of areas, as it prevents competitors from copying or closely imitating a company's products or services; avoids wasteful investment in research and development (R&D) and

marketing; creating a corporate identity through a trademark and branding strategy; negotiating licensing, franchising or other Intellectual Property based contractual agreements; increasing the market value of the company; acquiring venture capital and enhancing access to finance; obtaining access to new markets and most important a careful search for conflicting existing Intellectual Property rights, and the examination of application by offices can help an enterprise to avoid conflicts and unnecessary litigation.

Need for Effective Strategies of IPR Management

The effective management of intellectual property assets requires implementation of a comprehensive asset management plan. In this process one of the most important step is to review the existing intellectual property assets, so as to identify and locate the company's key intellectual property assets such as patents, patentable subject matter, copyrights, trade marks, designs, trade secrets, domain names, mask works, inventions, works of authorship, hardware and devices, depending upon the nature of business. Once the intellectual property assets are identified, it becomes important to determine nature and scope of the company's rights in intellectual property assets, which may range from outright ownership to a licence-including contingent rights in intellectual property to be developed in future.

The capitalizing on intellectual property assets so identified require a most constructive approach keeping in view, among others , type of intellectual property assets, the type of business claiming ownership of intellectual property assets, long term and short term goals of the business organization including intended/ possible use of intellectual property assets.

Intellectual Property – Risk Management

The ownership and control of intellectual property also attract certain risks and this requires strategies and plans to mitigate those risks. The most important among others being the infringement of rights in intellectual property, the risk management strategy should take into consideration the situations where company's own Intellectual Property Rights (IPRs) may infringe the IPRs of a third party; the company has a valid claim of infringement against a third party. It is also important to analyse the scope of any grant of rights in intellectual property assets, which may include licences, distribution agreements, reseller arrangements and any other agreement or transaction involving transfer of IPRs that may impact its value.

One of the most important IPR risk management techniques, particularly in respect of trade secrets, is to put in place a system requiring all new employees and consultants to execute a confidentiality agreement. It indeed will allow company to establish ownership in IPRs developed by the employees during their employment and also help company to effectively contest infringement in case employee leaves the organization and disclose the same to new employer.

Therefore, in nutshell, effective management of Intellectual Property enables companies to use their intellectual property to improve their competitiveness and strategic advantage. Acquiring Intellectual Property protection no doubt is crucial but its effective management provides much more than just protection to an enterprise's inventions, trademarks, designs, or copyright.

Effective intellectual property management requires a company to commercialize its inventions and effectively monitor and enforce its intellectual property rights. Indeed, a company's portfolio of Intellectual Property must be viewed as a collection of key assets that add significant value to the enterprise. Thus, effective management of intellectual property may be seen as critical business strategy to maintain sustainable corporate growth and maximisation of shareholder value resulting into the economic growth.

7. VALUATION OF INTELLECTUAL PROPERTY

How much is the Coca-cola brand or trade mark worth? In an article in August 2003 issue of Business Week, Interbrand included it in their table of 'The 100 Top Brands' at a value of US \$ 70.45 billion. This valuation shows the importance of Intellectual Property assets in today's globally competitive environment. The debate about the value of the intellectual property was non-existent in the sixties and the seventies. It was only during the last decade that the discussion has received the attention of all concerned.

Strategic assets are the key drivers for companies that enable them to achieve a sustainable competitive advantage. Strategic assets are a focal point for business management and intellectual property is part of those strategic assets. Most intellectual property has a calculable value based on the impact of the assets on the business enterprise in which it resides and the competitive environment. However, the process of assessing the value of intellectual property include challenges which may be enumerated as given below:

- (i) identifying the contribution of the intellectual

property to the company's competitive advantage;

- (ii) differentiating the specific assets from those attributed to other tangible and intangible assets; and
- (iii) quantifying the economic value of the assets.

The law on industrial property protects investors by granting them exclusive right to a specific asset, to exploit the asset to recoup the investment and a profit. To possess an exclusive right with respect to a technological invention or an image or good will represented by a trademark is one of the best competitive advantage, that a company can obtain. Such an exclusive right gives a company the possibility to fully control the prices or the production costs for the goods produced with a certain protected technology or with a new feature that the market has a demand for goods or services sold under a trademark with an appealing image.

The importance of industrial property is greater in a competitive market than in a regulated market. There are several situations when the value of intellectual property needs to be estimated. The most common of such situations are .-mergers and acquisitions; identifying royalty rates; financial reporting; taxation which includes purchase price allocation and transfer pricing; and litigation.

Mergers and Acquisitions

It is sometimes less costly to purchase an already established trademark or a patent protected technique than to establish or develop an alternative. An assessment of the value of the intellectual property of a company is essential in order to make the right decision and optimise capital use.

Royalty Rates

Instead of purchasing or developing an alternative technique or trademark, there is often a possibility of licensing the assets. In the process of finding a fair royalty rate, there is a need to analyse the assets and appraise the economic value, both for the licensor as well as the licensee.

Financial Reporting

Accounting standards the world over, prevent accounting for intellectual property; even though, the economic value could be substantial and sometimes even be the most valuable asset of a company. Many companies invest huge amounts in research and development, and in marketing. In such cases,

investments are treated as costs, not as investments, according to accounting rules. Investments in intangibles are often mere long-term than investments in tangible assets. A financial report based on the traditional accounting rules does not give a proper picture of the economic situation of the company. There is, therefore a need both for management as well as for investors and financial institutions to get information about the company's intellectual property assets.

Factors Affecting Economic Value of Intellectual Property

The value of all assets, tangible or intangible, is affected by the interest rate or cost of capital, but the individual value driving forces for industrial property include legal protection; market establishment; and financial aspects.

Legal Protection

Without legal protection that grants the owner the exclusive right in the intellectual property asset, seldom has any individual value. A good legal system for the protection of patents or trademarks is a fundamental requirement for creating values in the intellectual property.

Market Establishment

The market establishment in the context of trademarks, assumes various dimensions. A well-established trademark delivers a communication message, which is appealing for a certain segment of the market. This message is so appealing that customers are willing to pay a price premium compared to competitors offering comparable products or services. This creates profits and often an increase in the sales volume, and with that, an economy of scale, which decreases the production costs and generates higher profit margins. On the other hand, a trademark, which is legally protected through registration, but is not established on the market and without loyal customers, does not usually have any significant value. It is worth mentioning, that a well-established trademark is a powerful and lasting asset, and a company can make a profit out of it for years. Similarly in the case of patents, the closer an enterprise is to capitalising on the products based on the technology, the more valuable the protected technology is.

Financial Aspects

Assessment of the risk connected to the future intellectual property profits or earnings is of great importance for identifying a correct and reliable value

of the assets, inflation, cost of capital, profits margins, etc., are all important factors in the valuation of intellectual property. An intellectual property asset that is protected and established on the market, but does not produce any-profit, through actual or potential production - costs, savings or price premiums, has a very marginal value.

Methods for valuation of Intellectual Property

The holder of intellectual property needs to assess the current and potential value of the asset under each scenario. The holder may also have to assess the value of company's property, to decide it should license-in and, if so, on what terms. Before evaluating intellectual property, the valuer must gain an understanding of the purposes and nature of the valuation, in order to determine the basis of valuation and appropriate valuation methodologies. There are several methodologies which exist for identifying the-value of intellectual property and it is upto the valuer to identify the correct valuation method from among the prevalent approaches of valuation namely, cost-based: market-based: and economic based.

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REFORMS IN INSOLVENCY LAW — A COMPARATIVE ANALYSIS OF SELECT COUNTRIES

DR S K DIXIT* & PURUSHOTTAM GROVER**

INTRODUCTION

As is well known a company has many characteristics of a living being and therefore cannot remain static. It either has to grow or decay; reform or deform; regenerate or degenerate. In this highly competitive environment some companies may prosper and grow, while some may incur losses and may have to be ultimately extinguished or closed as they become insolvent.

The concept of insolvency are accordingly as old as trading on credit and indeed many of the concepts underlining the modern law of insolvency can be traced back to Greek and Roman systems. In primitive systems, a debtor's inability to pay could lead to imprisonment or slavery. However, all civilised systems, realise that this is neither a fair nor a cost effective system for dealing with default. At the base of all insolvency systems is a desire to distribute the insolvent's assets justly amongst the creditors. This prevents there being a disorganised scramble and ensures that every creditor is treated fairly. The principles of individual bankruptcy have generally been applied to corporate insolvency once the limited company came to be recognised under the law. The limited company has, however, always posed a rather different problem as by its nature it offers its directors and shareholders a shield from direct personal liability. The creditors can only look to the company's assets.

Insolvency has been defined to mean "the state of one who has not property sufficient for the full payment of his debts", and normally one feels uncomfortable reading or talking about this eventuality, however this subject needs to be discussed. Therefore, an attempt has been made in the following paragraphs to present legal points of view regarding corporate insolvency with respect to India and some other countries.

INSOLVENCY LAW – GLOBAL PERSPECTIVE

International insolvency has over the years gained a prominence, excited much interest, aroused speculation in the fields of both academia and practice, that seems amply justified in light of the often spectacular insolvencies on an international scale, particularly those which have affected institutions in the financial sector. Apart from this, the increasing cross border business ventures has made it necessary to be aware of the legislative framework with regard to corporate insolvency and latest developments in other countries.

During the last decade of the last century, corporate insolvency laws and related practices have assumed an unparalleled national, regional and global importance. This indeed is influenced by economic recession, collapse of command economy and Asian Economic crises.

These incidences exposed the inadequacy of corporate insolvency law regimes and led to widespread endeavors to improve the quality of the insolvency laws and their application. These economic and historical events have made an indelible and revolutionary mark on national, regional and global insolvency law development.

The reform in insolvency law has been driven by the recognition that insolvency and related laws are vital to economic development and stability. Following paragraphs provide a picture of reforms in insolvency law initiated by select countries.

UK-White Paper on Competition and Insolvency

The UK Government had published a White Paper on Insolvency as part of a package of wide-ranging reforms to competition and insolvency rules.

* Deputy Director, the ICSI. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

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The White Paper considered insolvency reform from two angles, the corporate and the personal.

In respect matters of corporate insolvency, the Government aimed to create a fairer system for insolvency matters, one in which there is a duty of care to all creditors, who are all able to participate.

The major proposals regarding corporate insolvency included:

- To remove the right of the holder of a floating charge to appoint an administrative receiver; this will apply to all except recognised investment exchanges or clearing houses.
- To streamline the administration procedure so that it becomes a fully effective procedure under all circumstances.
- To abolish the issue of Crown preference in all cases of insolvency i.e., removing the right of the VAT and the taxman to take priority over ordinary creditors. However, this will not affect the rights of employees to be treated preferentially in respect to wages and holiday pay.

As regards the streamlining of administration orders, it was proposed -

- To make the procedure more effective and accessible,
- To give ordinary creditors a greater say in the insolvency process and its outcome, and
- Not to make secured creditors who presently have the right of veto, feel at risk.

The White Paper also contained a number of significant changes to the existing procedure:

- Secured creditors to lose their power of veto.
- The three-month period referred in Section 23 of the Insolvency Act, 1986 to be reduced to 28 days, subject to any leave of the Court to extend it.
- Consideration to be given to extending the criteria of eligibility, so as to enable foreign companies to apply for protection by way of an administration order.

ENTERPRISE ACT, 2002

Based on the proposals under White Paper, the Enterprise Act, 2002 has been enacted. This Act has replaced Part II of the Insolvency Act, 1986. The changes to the existing corporate insolvency regime as contained

in the Enterprise Act 2002 (which amends the Insolvency Act 1986) focus on:

1. streamlining the procedure for administration (Schedule 16 of the Enterprise Act 2002)
2. restricting the use of administrative receivership (s.250 Enterprise Act 2002)
3. abolition of Crown preference (s.251 Enterprise Act 2002)
4. providing for unsecured creditors to share in a part of floating charge recoveries (s.252 Enterprise Act 2002).

Streamlining Administration

An administrator of a company may be appointed:

- (a) by order of the court following application by the company, its directors or one or more creditors (as now)
- (b) out of court by the holder of a "qualifying floating charge" (i.e. a floating charge which specifically states that the Act applies to it or purports to empower the holder to appoint an administrator or administrative receiver)
- (c) out of court by the company or its directors.

New statutory objectives for administrators

Overarching purpose of the administrator is to carry out its functions with the objective of rescuing the company as a going concern. Where not practicable, other statutory objectives apply.

Administration creates a moratorium during which no insolvency proceedings or other legal proceedings, including enforcing security, can be taken without the consent of the administrator or permission of the court.

The holder of a "qualifying floating charge" must be notified if the company or its directors intend to appoint an administrator who can appoint its own choice administrator instead.

Restricting administrative receivership

The holder of a "qualifying floating charge" in respect of a company's property will be prohibited from appointing an administrative receiver of the company unless one of the six exceptions set out below applies. (It is likely that two further exceptions will be added relating to urban regeneration projects and special administrations.) This will apply to any floating charge created on or after the date the relevant provisions come

into force and ensures that subject to the six exceptions below, a floating charge holder will no longer be able to block the appointment of an administrator (by appointing an administrative receiver) and will instead have the right to appoint an administrator. However, an administrative receiver may still be appointed under a “qualifying floating charge” created before the date the relevant provisions come in to force and these are often called “grandfathered floating charges”.

The six cases in which an administrative receiver may still be appointed by floating charge holders (and prevent the appointment of an administrator) are as follows (see sections 72B to G of the Insolvency Act 1986, to be found in section 250 of the Enterprise Act 2002) :

- Capital markets - capital market arrangement involving a debt of at least £50m (amendments are likely to be made to this exception);
- Public-private partnership (PPP) public-private partnership project with step-in-rights;
- Utility project (railways/gas etc) where floating charge granted over property of a project company of utility project which includes step-in-rights;
- Project finance - financed project which includes step-in-rights and where project company incurs a debt of at least £50m for purposes of project;
- Financial market - floating charge granted in favour of recognised investment exchange, clearing house, stock exchange or settlement bank for certain specified purposes;
- Registered social landlord (i.e. housing associations).

Abolition of Crown preference

A floating charge ranks behind “preferential debts” of a company. Preferential debts currently include debts due to the Inland Revenue and Customs and Excise and social security contributions. The Enterprise Act 2002 has abolished these categories of preferential debt and they therefore no longer have a right to be paid ahead of floating charge holders. Other “preferential debts” (i.e. contributions to occupational pension schemes, certain remuneration of employees) will continue to be paid in priority to the claims of floating charge holders.

Unsecured creditors

Currently a floating charge holder ranks ahead of unsecured creditors. Under the Enterprise Act 2002, a

prescribed part (likely to be capped at £600,000) of the company's “net property” will be distributed to unsecured creditors (after taking account of preferential debts, fixed charges and costs) and not to floating charge holders. This will not apply if net property is below a minimum threshold (likely to be £10,000) and liquidator, administrator etc. thinks costs outweigh benefits.

Singapore

The relevant Singapore legislation on corporate insolvency is contained in the Companies Act providing for liquidation and schemes of arrangement processes.

Singapore has largely abandoned the scheme of arrangement process as its principal corporate reorganization process. This was the result of some substantial reform to the Companies Act in 1987 when a new corporate rescue process, known as ‘judicial management’, was introduced. This has received some considerable success.

The judicial management process was introduced to overcome, in part, the failings of the scheme of arrangement process, as being slow, cumbersome, expensive and generally inefficient. It also did not provide for sufficient protection for a company during the time that it might take to determine if it might be restructured. The judicial management process allows a company that is unable to pay its debts to apply for the appointment of a judicial manager. The creditors of such a company may also apply. The court may appoint a judicial manager who then manages and controls the company to the exclusion of the directors. An automatic stay of actions and proceedings against the company operates. The judicial manager is then required to propose a plan for the reorganization of the company. The plan must be approved by a majority of the creditors.

Japan

The provisions relating to liquidation of companies are contained in the Bankruptcy Law, 1922. Japan has three potential rescue processes. The most commonly used are the corporate reorganization process under the Corporate Reorganization Law, the composition under the Composition Law, and third is the company arrangement process.

The company arrangement process involves an application to a court to commence the process. This is generally accompanied by an application for suspension of actions against both secured and unsecured creditors. The directors continue to manage the company under the supervision of the court. A plan of arrangement is

prepared and submitted to creditors for approval. It is a requirement of this process that approval must be unanimous. If the plan is not approved the corporation is liquidated or the process may be converted into the composition process.

The composition process requires that an application be made to a court accompanied by a plan of composition. An investigator is appointed to report to the court on the plan and the condition of the corporation. Management continues as before. An application may be made to stay or suspend actions, but only actions of unsecured creditors. Unsecured creditors then consider the plan. Secured creditors are not restrained nor affected by the process in any way. Approval of a plan of composition requires a three quarter majority vote in favour by all creditors and fifty per cent of creditors present and voting at the meeting of creditors. It then becomes binding on all unsecured creditors. Performance of the plan is not, however, supervised. If the plan is not approved the corporation is liquidated.

The main rescue process is corporate reorganization. It is extremely involved and is suitable for large public companies only. The procedure requires the filing of an application with a court. There is no automatic stay or suspension of actions against the corporation. It is usual, therefore, that an application for an interim stay has to be made to protect the property of the company. An interim trustee is normally appointed at the same time. It takes control of management of the corporation. The court then undertakes a process of inquiry of the corporation; major creditors; main shareholders, management and representatives of employees of the corporation.

If the court is satisfied that the conditions necessary for the commencement of the case are fulfilled, it issues an order to that effect. It is only at this point that there is an automatic permanent suspension of actions. The appointment of the trustee is confirmed and the trustee continues to control the corporation. An interim meeting of creditors occurs at which the trustee and management give information concerning the corporation. The trustee is required to prepare a plan of reorganization. This can take up to two years. The plan is then submitted for consideration by the creditors. There is a complicated voting requirement for approval of the plan. In effect, this requires a majority vote of two thirds of the unsecured creditors (in value), three quarter's majority of secured creditors and a majority of shareholders. The court must also sanction the plan.

If the plan is not approved the corporation will normally be liquidated.

Korea

The Bankruptcy Act, 1962 provides for the liquidation or bankruptcy of a corporation. The Composition Act, 1962 provides for the possibility of a compromise of the debts of a corporation and the Company Reorganization Act, 1962 provides for the possible rehabilitation of a corporation.

A debtor corporation is allowed to file for a composition. The composition procedure is designed for temporary relief. At the time of filing the debtor must propose the terms of the composition and a plan to perform the composition. A liquidation commissioner is appointed to review the corporation and the proposal. The management of the corporation continues in power. A meeting of creditors considers and votes for the approval or otherwise of the composition. If the composition is not approved, the corporation cannot be transferred to a liquidation process.

The corporate reorganization process differs from the composition procedure because it is aimed toward reorganizing or rebuilding a debtor corporation. Under the reorganization process the company makes an application to a court which then determines if the reorganization should commence. During this process of consideration the court can make interim orders and appointments to protect the property of the company and place the management of the company in the control of a receiver. If the court accepts the application a permanent stay of actions takes effect and the court appoints a permanent receiver, who effectively displaces management. A timetable is set for the submission of a reorganization plan.

A reorganization plan is then submitted to the creditors and must be approved by a complicated voting majority of creditors of various classes. The court must then authorize the reorganization plan to be implemented. The implementation of the plan is under the control of the receiver.

The insolvency law regime system in Korea is presently under extensive review through the Ministry of Justice and the International Bank for Reconstruction and Development.

Philippines

The Insolvency Law, provides a liquidation (or 'insolvency') process. The Insolvency Law also provides for a form of 'rescue' process known as 'suspension of

payments'. It is only available to a corporation that has assets sufficient to meet its debts. It requires an agreement to be made between the corporation and its creditors for the eventual payment of the debts in full.

In 1976, a Presidential decree known as PD902A was issued taking the jurisdiction regarding corporations away from the regular courts and to give the Securities and Exchange Commission. In addition, an alternative to suspension of payments known as 'rehabilitation' was introduced enabling a corporation whose assets do not exceed its liabilities to apply to the SEC for the appointment of a rehabilitation receiver and/or management committee and then to develop a rehabilitation plan.

Although the rehabilitation process has operated with some apparent success, there has been a clear need to provide greater transparency, predictability and fairness in the procedure. On January 15, 2000, the SEC's newly enacted Rules of Procedure on Corporate Recovery took effect.

Indonesia

The corporate insolvency regime of Indonesia is contained in the Bankruptcy Ordinance 1905 providing for a liquidation or bankruptcy process and a form of composition or suspension of payments process. However, Bankruptcy Regulations were effected in 1998 supplementing and amending the Bankruptcy Ordinance and substantially expanding and reforming the suspension of payments process.

There are two "rescue" processes available under the Insolvency Law of Indonesia. The first is commenced by the debtor (or creditors) filing a petition for bankruptcy. A stay or suspension of all actions takes effect for 90 days. If, within that time, the debtor corporation presents a plan of composition and creditors approve it, the plan takes effect. If a plan is not proposed the debtor is liquidated.

The second process is commenced by a corporation filing a request for suspension of payment of debts. This is then followed by a temporary suspension of payments for a maximum period of forty-five days during which time the proposal for the permanent suspension of payments must be prepared for negotiation between the debtor and the creditors. The affairs of the debtor corporation are jointly managed by court appointed administrators and by the debtor. If the proposal is presented within that time the court may order a permanent stay which is effective for a period of 270

days. The plan must then be negotiated during that time. The creditors vote on the proposal. If it is refused the court may proceed with the liquidation of the debtor corporation.

Thailand

The provisions relating to corporate insolvency are contained in the Bankruptcy Act, 1940. Prior to 1998, the Thai law contained a liquidation (or bankruptcy) process and a composition process. There was no rescue or reorganization process. However, as a result of the economic crisis, Thailand reformed the law in 1998 by introducing a new chapter on 'business reorganization'. It applies only to corporations, banks, security and insurance corporations. A debtor corporation, a creditor of a debtor corporation or the respective regulatory authorities of the banking, insurance and securities sectors may make an application for business reorganization.

A request for reorganization is filed with the bankruptcy court. It must determine whether or not to accept the request. If the request is accepted, an immediate stay or suspension against all actions and proceedings comes into force. A 'planner' is required to be appointed who has the legal authority to manage the affairs of the corporation. The 'planner' prepares a plan of reorganization. The plan must be prepared within three months of the appointment of the planner and forwarded to the official receiver and to all creditors. A meeting of creditors is convened to discuss and approve or disapprove the plan. The court must then approve the plan.

INSOLVENCY LAW – INDIAN STANCE

Existing Provisions

In India we do not have any separate statute relating to corporate insolvency. However, the Companies Act, 1956 provides for law relating to corporate insolvency and *inter alia* contains the provisions for winding up of companies in Parts VII & X (Sections 425 to 560; Sections 582 to 590).

Usually, companies in financial difficulties alone are wound up. However, legally, even a financially sound company can also be wound up. Winding up is the process of bringing to end the legal personality of a company as a corporate body. The broad steps are:

- Take out affairs of company from hands of directors.
- Hand over management of company to liquidator.

- The liquidator to take possession of assets of the company.
- Realise assets of company.
- Discharge debts and liabilities to the extent possible in order of priority.
- Distribute surplus, if any, among members on pro rata basis.
- Order dissolution.

The corporate entity of a company continues to exist till the company is finally dissolved. Winding up process can be revoked and company can again start functioning, subject to certain conditions.

A company can be wound up in one of the following ways:

- Members' voluntary winding up
- Creditors' voluntary winding up
- Winding up subject to supervision of the court
- Compulsory winding up by order of court

In addition, Registrar of Companies has power under section 560 to strike off the name of a defunct company from the register. An unregistered company or a foreign company can also be wound up under the provisions of Companies Act.

A company may be wound up by Court in the following circumstances:

- (a) If the company has, by special resolution, resolved that the company be wound up by the Court.
- (b) If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting where applicable.
- (c) If the company does not commence its business within a year from its incorporation or suspends its business for a whole year.
- (d) If the number of members is reduced below statutory minimum – i.e. below seven in case of a public limited company and two in case of a private company.
- (e) If the company is unable to pay its debts.
- (f) If the Court is of the opinion that it is just and equitable that the company should be wound up.

High Level Committee on Law Relating to Insolvency

Overhauling to ensure a time bound framework for revival or winding up of a company in a free market economy, the Government constituted a High Level Committee on Law Relating to Insolvency and winding up of Companies to examine the existing laws relating to winding up proceedings of companies in order to remodel it in line with the latest developments and innovations in corporate laws and governance and to suggest reforms so as to avoid unnecessary delays and to be in tune with the international practice in this area.

The Committee not only examined the Companies Act, 1956 but also other relevant laws having a bearing on the subject such as Sick Industrial Companies (Special Provisions) Act, 1985; Recovery of Debts due to Banks and Financial Institutions Act, 1993; Report of the United Nations and International Monetary Fund and UNCITRAL Model Law on Cross-Border Insolvency.

In view of the involvement of different agencies in various aspects of corporate functioning, i.e. High Court, CLB and BIFR, the Committee recommended the establishment of National Company Law Tribunal (NCLT) as a specialized agency to deal with matters relating to rehabilitation, revival and winding up of companies and suggested adoption of UNCITRAL Model law in the Companies Act to deal with cross border insolvency.

The Committee also considered Insolvency laws of developed countries and recommended adoption of Administrative Order procedure on the lines of U K Insolvency Act, 1986 and to maintain a panel of professional Insolvency Practitioners to introduce an element of professionalism in winding up of Companies.

With a view to taking care of the interests of all stakeholders particularly the labour, the committee recommended setting up of a Fund for Revival and Rehabilitation of Companies and also for preservation and protection of assets of the company during winding up.

In order to implement the recommendations of the High level Committee on law relating to Insolvency and winding up of Companies the Government enacted the Companies (Second Amendment) Act, 2002. The salient provisions of the (Amendment) Act are given below:

- (i) The Section 425, which deals with the modes of winding up and includes winding up by the Court amended so as to confer all the powers

- of winding up of a company upon the National Company Law Tribunal (Tribunal) instead of a Court. The winding up subject to the supervision of the Court has been omitted.
- (ii) Section 433 which specifies the circumstances in which Court may wind up the company, is substituted to provide that the Tribunal instead of a Court shall wind up the company. Three new clauses has been added in the said section to provide for grounds for winding up of a company in addition to the existing grounds of winding up. The new grounds provide that a company may be wound up by the Tribunal if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, the friendly relations with foreign States, public order, decency or morality or if the company has made a default in filing with the Registrar its balance sheets and profit and loss account or annual returns for five consecutive financial years or if the Tribunal is of the opinion that the company should be wound up under the circumstances specified in the new Section 424G.
 - (iii) The existing minimum limit of Rs. 500 enhanced to Rs. 1 lakh when a company shall be deemed unable to pay its debts under section 434.
 - (iv) A new section 439A inserted to provide that every company shall file a statement of its affairs along with the petition for winding up before the Tribunal. Such statement of affairs shall include details such as the last known addresses of all the directors and names and addresses of the company secretary; the details of location of assets of the company and their value; and the details of debtors and creditors with their addresses the details of workmen and other employees and any amount outstanding to them and such other details as the Tribunal may direct.
 - (v) Section - 446A inserted, requiring directors and other officers of every company to ensure that books of account of the company are completed and audited up to the date of winding up order made by the Tribunal and submitted to it at the cost of company failing which such directors and other officers shall be liable for punishment for a term not exceeding one year and fine for an amount not exceeding one lakh rupees.
 - (vi) Section 448 dealing with appointment of Official Liquidator and empowering the Central Government to appoint one or more Deputy Official Liquidator or Assistant Official Liquidator to assist the Official Liquidator, has been substituted to provide for appointment of an Official Liquidator from a panel of professional firms of Company Secretaries, Chartered Accountants, Cost & Works Accountants and Advocates or a body corporate consisting of combination of such professionals as approved by the Central Government or whole time or part time officers appointed by the Central Government. The amount of remuneration payable to such Official Liquidators who are appointed from such panel of professionals shall be approved by the Tribunal. The new section also confers power upon the Tribunal to transfer the work assigned from one Official Liquidator to another Official Liquidator, remove the Official Liquidator for professional misconduct.
 - (vii) Section 459 which empowered the Official Liquidator with the sanction of the Court to appoint an advocate, attorney or pleader entitled to appear before the Tribunal to assist him in the performance of his duties, has been substituted to provide that the liquidator may, with the sanction of the Tribunal, appoint one or more chartered accountants or company secretaries or cost accountants or legal practitioners to assist him.
 - (viii) Sections 460 to 465, relating to exercise and control of liquidators' powers, books to be kept by liquidator, audit of liquidator's account, control of Central Government over liquidators, appointment and composition of committee of inspection and constitution and proceedings of Committee of inspection, are amended to confer the powers upon the Tribunal which vested with the Court.
 - (ix) Section 478 (3) provides that any creditor or contributory may also take part in the examination of promoters, directors, etc., either personally or by any advocate, attorney or pleader entitled to appear before the Court and sub-section (6) provides that a person ordered to be examined may at his own cost employ such an advocate, attorney or pleader. It provided that the creditor or contributory or such person may appoint one or more chartered accountants or company secretaries or cost

accountants or legal practitioner entitled to appear before the Tribunal under Section 10GD.

- (x) Section 483 has been amended to empower the National Company Law Appellate Tribunal to hear the appeals against the orders of NCLT. However, the Court shall continue to hear the appeals against any order made or decision given before the commencement of the Companies (Second Amendment) Act, 2002.

COMPANY SECRETARY AS LIQUIDATOR

The amendments in the Companies Act with regard to Official Liquidator, has opened up a new area of practice for Company Secretaries. They can be empanelled along with other professionals to be appointed as Official Liquidators by the Tribunal.

The Official Liquidator may with the sanction of the Tribunal appoint one or more Company Secretaries or other professionals to assist him in the performance of his duties.

The Company Secretary in Practice will be authorised to appear before the Tribunal.

The Company Secretary in Practice having atleast 15 years working experience as secretary in whole-time practice is qualified for appointment as a technical member of the Tribunal.

All these recognitions apart from increasing the areas of practice provide not only ample scope for Company Secretaries to play an active and vital role in the process of winding up of companies but also pave way for them to gain greater expertise in this area which will be in line with the global changes in this regard.

The Companies (Second Amendment) Act, 2002 has received the assent of the President of India and the provisions relating to establishment of National Company Law Tribunal and Appellate Tribunal have come into force. The other provisions of the Amendment Act providing transfer of powers to NCLT are likely to be notified and come into force once NCLT is established.

SURVEY OF GOOD PRACTICE STANDARDS IN INSOLVENCY LAW OF SELECT ASIAN COUNTRIES

The Asian Development Bank in its Report on Insolvency Law Reforms in the Asian and Pacific Region identified and enumerated basic standards required to be incorporated in an acceptable Insolvency Law. Those cover only the more essential areas critical to debtor

creditor relationships in a corporate insolvency environment. These standards are given below :

1. An insolvency law regime should clearly distinguish between, on the one hand, personal or individual bankruptcy and, on the other, corporate bankruptcy.
2. All corporations, both private or state-owned (with the possible exception of banking and insurance corporations), should be subject to the same insolvency law regime.
3. The optimum design of a corporate insolvency law regime should incorporate both liquidation and rescue processes by a 'one law, two system' convertible design. This may be either a pure unitary or modified unitary design. In a modified unitary system the law should provide, in particular for conversion from the reorganization process to the liquidation process.
 - 4.1 A debtor should have easy access to the law by providing simple threshold proof of the basic criteria (insolvency or financial difficulty). The debtor through its directors or board of management may conveniently provide a declaration to that effect. There should be sanctions for false declarations.
 - 4.2 A creditor should be required to establish threshold proof of insolvency by evidencing a presumption of insolvency on the part of the corporate debtor. Clear evidence of the failure of a corporate debtor to pay a matured debt is all that should be required to evidence such a presumption.
 - 5.1 **Liquidation.** If it is determined that a debtor corporation should be liquidated, the powers of the existing management should be terminated and an independent administrator appointed to exercise those powers and to conduct the liquidation.
 - 5.2 **Reorganization.** Existing management should, generally continue, subject to the exercise of supervisory power by an independent administrator but with the possibility, if circumstances require it, of the independent administrator assuming complete power.
 - 5.3 **Liquidation.** A stay or suspension of actions and proceedings against the property of a debtor corporation should be immediate, but confined to unsecured creditors only. There should be no interference with or stay upon the rights of

- secured creditors, owners of leased property or the like.
- 5.4 **Reorganization.** The automatic stay or suspension of actions should be as wide and all embracing as possible. It should apply to all creditors (secured or otherwise) and to persons having an interest in property used, occupied or in the possession of the debtor (such as lessors of property, retention of title claimants and the like).
- 5.5 The stay should be of limited specific duration and should provide for the possibility of relief from the stay on the application of affected creditors or other persons to the court or tribunal.
- 5.6 The law should sanction and provide for a commercially sound form of safe 'priority' for funding that is necessary for the on-going and urgent business needs of a debtor during the rescue process.
- 6.1 The insolvency legislation should provide for swift and strict time limits for the initial process regarding an insolvent corporation. The court or other tribunal system must be properly resourced to enable the process to be implemented.
- 6.2 The medium term administration of an insolvent corporation that is being reorganized (for example, from the time of commencement to the time that a plan is approved or not) also requires the application of a sensible time frame. The long-term administration of a company that is being liquidated requires efficient continuous handling.
- 7.1 The administration of a corporation in liquidation is a public responsibility and should be viewed as part of the overall regulation of corporations. It is possibly best handled by a specialist government agency, which must be adequately resourced and financed.
- 7.2 The law should require that creditors are informed of the progress of the administration at relevant stages.
- 8.1 The law should prescribe, as fully as possible, for the provision of relevant information concerning the debtor.
- 8.2 It should also provide for independent comment and analysis on the information.
- 9.1 An insolvency law should make proper provision for the involvement of creditors as part of the liquidation or rescue process.
- 9.2 An insolvency law should clearly define the voting rights of creditors and should prescribe minimum requirements for the approval of a plan of rescue.
- 9.3 Provision should be made for voting by classes of creditors, particularly secured creditors, if the rescue proposal is required to bind such classes.
- 9.4 The law should provide protection against manipulation of the voting system and, in particular, should ensure that a court or other tribunal is empowered to set aside the results of voting which are obtained by the exercise of votes of insiders or persons who are related to the corporation, its shareholders or directors.
- 9.5 The effect of a vote of the requisite majority of a class should be made binding on all creditors of that class.
- 10.1 The law should not prescribe the nature of a plan, except in regard to fundamental requirements and to prevent commercial abuse. In particular, the law should not intrude into the 'commerciality' of a plan except to ensure that the result of a plan will provide a greater benefit to creditors than in a liquidation of the debtor.
- 10.2 The law should provide for objective analysis of a proposed plan by an independent adviser. In particular, it should be demonstrated that the proposed result or effect of a plan is commercially sound.
- 10.3 The law should provide for a plan to be provided, nominally by the debtor, within a specified period of time.
- 10.4 The law should provide for a court or other tribunal to have a general supervisory role of the rescue process. In particular the court or tribunal should be empowered to set aside the approval of a plan if it is shown that it is not in the best interests of creditors considered as a whole.
11. Provision should be made for the possibility that the execution of a plan may require supervision or control by an independent person.
- 12.1 A plan should be capable of amendment (by

vote of the creditors) if it is in the interests of the creditors.

- 12.2 The law should provide for the debtor to be liquidated upon the termination of a plan as a result of non-performance of the plan.
13. An insolvency law regime should, as far as possible, preserve the principle of equal treatment for all creditors. Accordingly, the insolvency law should limit the number of priority claims to as few as possible.
14. An insolvency law regime should contain adequate provisions relating to avoidance of transactions, which result in damage to creditors or conflict with the principle of equal treatment of creditors of the same class.
15. An insolvency law regime should contain provisions for the civil sanction of fraudulent and other like conduct in the operation and management of a corporation, which causes damage or loss to creditors of an insolvent corporation.
16. An insolvency law regime should include provisions relating to recognition, relief and co-operation in cases of cross-border insolvency, preferably by the adoption of the UNCITRAL model law on cross-border insolvency.

The Asian Development Bank in its report applied these basic standards to assess the insolvency regime of select Asian countries. The table providing the picture about application of ADB standards by specific countries is placed as Annexure.

CONCLUSION

As the Company Secretaries are advising the managements of companies of India in their global plans to form joint ventures and establishing businesses abroad it becomes imperative for them to understand the regulatory framework of insolvency in various countries, and the changes in addition to the amendments in law relating to corporate insolvency that have taken place in India.

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Table

INTELLECTUAL PROPERTY — A COMPETITIVE EDGE FOR CORPORATES IN DYNAMIC GLOBAL BUSINESS ENVIRONMENT

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INTRODUCTION

With the liberalization of trade and economy, the significance of intellectual property has considerably increased. Intellectual Property rights are key elements needed to maintain a competitive edge in the market in today's dynamic and competitive business environment. Intellectual property is a business asset, an integral part of the business process. Effective acquisition, management and protection of intellectual property can mean the difference between success and failure in businesses today.

Mentioned above, Intellectual property is considered to be a business asset. But in developing countries particularly in India the significance of intellectual property is yet to be fully appreciated by the corporate sector. Every business organization, whether it is manufacturing or service oriented uses and creates intellectual property. The intellectual property so generated can assist the business in its marketing, product development, exports, raising financial resources and also expanding the existing business through licensing and franchising. It has thus become vital for business organizations to create an environment that is conducive and would harness intellectual property for strategic competitive advantage. Corporates often face challenges in extracting the hidden value of intellectual property and using it effectively as part of its business strategy. Moreover, when intellectual property is not protected somebody else might misappropriate the same, competitors might take advantage of the unprotected intellectual property, and opportunities to licence, sell or transfer technology will be severally hindered. To promote innovativeness, corporates should introduce an *Intellectual Property Management System* wherein appropriate intellectual property tools are deployed to protect, manage and enforce the intellectual property so as to get the possible commercial results from its ownership.

WHAT IS INTELLECTUAL PROPERTY ?

Intellectual property encompasses the properties that are the creations of the human mind, labour, capital and intellect like inventions, literary and artistic works, and symbols, names, images, and designs used in commerce. Intellectual property is divided into two categories: Industrial property, which includes inventions (patents), trademarks, industrial designs, and geographic indications of source; and Copyright, which includes literary and artistic works such as novels, poems and plays, films, musical works, artistic works such as drawings, paintings, photographs and sculptures, and architectural designs. Rights related to copyright include those of performing artists in their performances, producers of phonograms in their recordings, and those of broadcasters in their radio and television programs.

The most noticeable difference between intellectual property and other forms of property, however, is that intellectual property is intangible, that is, it cannot be defined or identified by its own physical parameters. It must be expressed in some discernible way to be protectable. Generally, it encompasses four separate and distinct types of intangible property — namely, patents, trademarks, copyrights, and trade secrets, which collectively are referred to as "intellectual property." However, the scope and definition of intellectual property is constantly evolving with the inclusion of newer forms under the gambit of intellectual property. In recent times, geographical indications, protection of plant varieties, protection for semi-conductors and integrated circuits, and undisclosed information have been brought under the umbrella of intellectual property. A brief description of these four types of intellectual property is given below:

- Patents protect inventions that are novel, non obvious with respect to the prior art and useful.

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The invention must be disclosed in a specified format in a patent specification. A patent once granted has a specific term and must be periodically renewed up to the term to retain the exclusive rights derived from it, such as the unauthorized production, use and sale of the invention.

- Copyrights are the rights given to creators for literary, musical and artistic works, such as novels and poetry, songs and musical scores, paintings and sculpture etc. for a certain period of time.
- Trademarks and service marks are primarily intended to indicate the source and distinguish goods and services of others. They also symbolize the quality of the goods or services with which they are used. Most trademarks and service marks are words, but they can be almost anything such as symbols, logos, sounds, designs, or even distinctive non-functional product configurations.
- A trade secret is information that is secret or not generally known in the relevant industry giving the owner an advantage over competitors. Trade secret protection exists as long as the information is kept secret or confidential by its owner and is not lawfully and independently obtained by others. Examples of trade secrets include formulas, patterns, methods, programs, techniques, processes or compilations of information that provide ones business with a competitive advantage.

These rights, conferred by law, can be given, sold, rented (called "licensing") and, in some countries, even mortgaged, in much the same way as physical property. However, the rights typically have limitations, sometimes including term limits and other exceptions (such as fair use for copyrighted works). Ownership of intellectual property rights is the legal recognition and reward received for ones creative effort. It is important to understand that it is the rights that are the property, and not the intellectual work they apply to. A patent can be bought and sold, but the invention that it covers is not owned at all. All these four types of intellectual property are protected on a national basis. Thus, the scope of protection and the requirements for obtaining protection will vary from country to country.

The domain of intellectual property being vast, in this paper we shall only discuss the significance of patents and trade secrets to the corporates.

As noted earlier, patents are granted for scientific inventions and for a specified period of time. Mention should be made that the World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) provides the international standard for duration of patent exclusivity, which is 20 years from the date of filing. After January 1, 2000, all WTO members are obligated to meet this standard. Under all patent systems, once this period expires, information enters the public domain and people are free to use the invention as they wish. The benefits of an effective patent system for the corporates can be partially illustrated as follows:

- (a) A patent rewards the investment of time, money, and effort associated with research. It stimulates further research as competitors invent alternatives to patented inventions, and it encourages innovation and investment in patented inventions by permitting companies to recover their research and development costs during the period of exclusive rights.
- (b) The limited term of a patent also furthers the public interest by encouraging quick commercialization of inventions, thereby making them available to the public sooner rather than later. Patents also allow for more latitude in the exchange of information between research groups, help avoid duplicative research, and, most importantly, increase the general pool of public knowledge.
- (c) Although the right conferred by a patent is a right to exclude others from making, using, or selling a patented invention during the term of the patent, it is important to understand that a patent does not necessarily give the patent owner the right to make, use, or sell the invention himself or herself. For example, the owner of a patent for an improved method of producing a chemical compound would not be free to sell the compound made using the patented method if the compound is itself patented by someone else. Although all WTO members are subject to patent provisions in the TRIPS Agreement, patents are granted under national laws and, therefore, the rights are also national in scope.
- (d) Any act of making, using, or selling the patented invention without permission infringes that patent, whether it be by the state, a corporation, or an individual. Any such infringing act will give rise to liability, regardless of the infringer's

intent or lack of knowledge of the patent. Remedies for patent infringement can include injunctions, orders to deliver up or destroy infringing articles, and compensation for damages suffered by the patentee or profits made by the infringer. An issued patent remains open to attack for invalidity, and it is a common defence for an alleged infringer to assert that the patent is invalid.

WHAT CAN BE PATENTED ?

It is important to understand what can be patented? It has been noticed that business organizations are not clear as to what they can patent. They confuse patents with trademarks and the vice-versa. Here professional counseling will be a useful tool for corporates to be clear about their intellectual property protection.

In this context, it is pertinent to quote the provisions of the TRIPS Agreement. Article 27 of the TRIPS Agreement provides that WTO member states shall provide patents for any invention, either a product or a process for creating a product, "provided that they are new, involve an inventive step, and are capable of industrial application." In other words, to be patentable, an invention must be novel, useful, and non-obvious. A prerequisite to patentability is that the invention must be capable of some practical application. This emphasizes the importance the patent system puts on usefulness.

The invention must be new — that is, the subject matter of the invention is not or cannot be inferred to be part of what is already known. This is commonly referred to as the "novelty" requirement. New or novel in this context means "new to the public." Therefore, something that has previously been used or known but has not been made available to the public (for instance, if it has been kept a secret) is not a bar to patentability.

The invention must also be non-obvious. This prevents someone from taking advantage of the patent system and obtaining protection for something that is a mere extension or trivial variation of what is known. Generally the test for inventiveness, or "nonobviousness," is based on what a reasonable person skilled in the field to which the invention pertains, at the time the invention was made, would consider to be non-obvious.

The TRIPS Agreement provides a transitional period for developing countries that do not currently provide product patent protection in the areas of agro-chemicals or pharmaceuticals. In fact, most already do because of the development benefits to the biotechnology sector

from full patent protection. Process patent protection does not encourage investment because of the difficulty of enforcing a process patent. It is particularly difficult to enforce a process patent because the burden of proof to show that the patent has been infringed is on the patent owner. Many countries have changed from "process" to "product" patenting, over the past 15 years and it is mandatory for all WTO members under the TRIPS Agreement to provide full product patent protection by January 1, 2005.

Not only are the utilitarian aspects of new and useful inventions patentable, but also many countries extend patent protection to novel, ornamental industrial designs. In the United States, this form of protection is known as a *design patent*, while in many European countries, the property right in an industrial design is referred to as a *design model*. In addition to such usual subjects of patent protection as devices, chemical compositions, and processes, some countries provide patent protection for living matter. As for instance, asexually reproduced varieties of plants, excluding bacteria, uncultured plants, and tuber propagated plants, can be protected, as can sexually reproduced plants (by seed), excluding bacterial, fungi, and first-generation hybrids. The TRIPS Agreement does not require protection for new living matter or plant varieties, but WTO members may join the International Union for the Protection of New Varieties of Plants, or UPOV.

RECENT TRENDS

Recently the general trend in intellectual property law has been expansion: to cover new types of subject matter such as databases, to regulate new categories of activity in respect of the subject matter already protected, to increase the duration of individual rights, and to remove restrictions and limitations on these rights. Another trend is to increase the number and type of what is claimed as intellectual property. This has resulted increasingly in broad patenting. Take the example of genetic engineering. The application of genetic engineering in plants and animals has resulted in exciting developments like transgenic cotton, transgenic soyabean and transgenic animals. The US biotechnology company Agracetus, which specializes in biomedical and plant products, is currently holding wide ranging patents on transgenic soyabean and cotton.

Recently the United States Court of Appeals for the Federal Circuit in *State Street Bank & Trust v. Signature Financial Group*, ruled that a patent on a "machine" that transforms financial data into a "useful, concrete and tangible result" is not invalid for failure to

claim statutory subject matter. This decision is likely to encourage companies to patent their computer systems and methods of doing business. The Court of Appeals ruled that:

- Whether a patent claim encompasses statutory subject matter should not turn on which of the four categories of subject matter the claim is directed to — process, machine, manufacture, or composition of matter — but rather on the essential characteristics of the subject matter, in particular, its practical utility.
- Although mathematical algorithms that are mere abstract ideas are not patentable, a practical application of a mathematical algorithm, formula, or calculation may be patentable if it produces a “useful, concrete and tangible result.”
- The “business method” exception to statutory subject matter is dead. Business methods are subject to the same legal requirements for patentability as any other process or method.

For the information of readers, the facts of the case cited above as well as its decision has been discussed in detail herein below:

In this case the patent owner, Signature Financial Group, had claims directed to a data processing system for managing a “Hub and Spoke®” financial services configuration, in which mutual funds (the “spokes”) pool their assets in an investment portfolio organized as a partnership (“the hub”). The system provides a mechanism for daily allocation of assets for two or more spokes that are invested in the same hub, and determines the percentage share that each spoke maintains in the hub while taking into consideration daily changes in the value of the hub’s investment in securities and in the corresponding amount of each spoke’s assets. The system offers the benefits of economies of scale in administering investments coupled with the tax advantages of a partnership.

State Street Bank & Trust, a major player in the financial services industry, negotiated with Signature Financial Group for a license to use the patented data processing system. When negotiations broke down, State Street Bank & Trust sued for a declaratory judgment that the patent was invalid, unenforceable and noninfringed, and filed a motion for partial summary judgment of patent invalidity for failure to claim statutory subject matter under § 101 of the Patent Laws. The district court granted the motion, and Signature Financial Group appealed.

The broadest claim in the patent describes the invention as comprising seven elements for managing a financial services configuration of a portfolio established as a partnership: “computer processor means” for processing data, “storage means” for storing data on a storage medium, and “first” through “fifth” means for manipulating the data. The district court ruled that the claim was directed to a process that fell outside the statutory classes of patentable subject matter under the “mathematical algorithm” exception and the “business method” exception.

On appeal, the Federal Circuit reversed. The Court first found error in the district court’s conclusion that claim first of the patent is a process claim rather than a machine claim, as the written description in the patent provides a physical structure corresponding to each “means” element of the claim. For example, the “computer processor means” element finds a corresponding structure in a personal computer including a CPU; “storage means” finds corresponding structure in a data disk; and “first” through “fifth” means for manipulating data find corresponding structure in five different arithmetic logic circuits.

The Court next observed that the Supreme Court has identified only *three categories of subject matter that are unpatentable per se: laws of nature, natural phenomena, and abstract ideas*. Although mathematical algorithms are not patentable subject matter to the extent that they are merely abstract ideas, in this case, the mathematical algorithms used in manipulating the financial data are not merely abstract ideas, but produce a useful result. Drawing on two previous decisions of the Federal Circuit, one of which recognized patentable subject matter in a machine that transforms data through a series of mathematical calculations to produce a smooth waveform on a display monitor, and another in which electrocardiograph signals from a patient’s heartbeat are transformed through a series of mathematical calculations into an expression of the condition of the patient’s heart, the Court ruled, in *State Street Bank & Trust*, that Signature Financial Group’s patent claims are directed to proper statutory subject matter:

Today, we hold that the transformation of data, representing discrete dollar amounts, by a machine through a series of mathematical calculations into a final share price, constitutes a practical application of a mathematical algorithm, formula, or calculation, because it produces “a useful, concrete and tangible result” — a final share price momentarily fixed for recording and reporting purposes and even

accepted and relied upon by regulatory authorities and in subsequent trades.

The Court of Appeals found error in the district court's application of the "Freeman-Walter-Abele" test for determining whether the claimed subject matter is an unpatentable abstract idea. The Court of Appeals explained that, in view of subsequent Supreme Court precedent, that test "has little, if any, applicability in determining the presence of statutory subject matter."

The Court of Appeals then turned to the "business method" exception to statutory subject matter, and took the opportunity "to lay this ill-conceived exception to rest." The Court observed that neither it nor its predecessor, the Court of Customs and Patent Appeals, has ever invoked the "business methods" exception, which was created by other courts prior to enactment of the 1952 Patent Act. Under that Act, business methods are subject to the same legal requirements for patentability as any other process or method. Earlier decisions to the contrary are neither controlling nor persuasive.

One basis for the district court's decision in *State Street Bank & Trust* was its concern that Signature Financial Group's patent claims were so broad as "to foreclose virtually any computer-implemented accounting method necessary to manage this type of financial structure." The Court of Appeals rejected that concern as not relevant to the statutory subject matter inquiry. The purported over breadth of the claims, said the Court, should be considered in the light of other sections of the Patent Law dealing with novelty, non-obviousness, and sufficiency of disclosure. The Court of Appeals reversed the summary judgment and remanded the case to the district court for further proceedings.

THE LIFE CYCLE OF INTELLECTUAL PROPERTY

The life cycle of intellectual property consists of four stages:

- Creating the intellectual property;
- Protecting the intellectual property;
- Utilizing the intellectual property; and
- Enforcing the intellectual property.

Creating the intellectual property : It is rare nowadays that individuals create intellectual property alone. Today, although individuals contribute to the creation of intellectual property, it is a collective endeavour that often involves huge R&D investment

funded by corporations. In order to protect their R & D investment, companies need to ensure that the company owns any and all work created by their employees and independent contractors. Only then the company can take full and complete licenses in capitalizing on such intellectual property.

Companies can be proactive in protecting their investment in intellectual property. To accomplish this, it is crucial that companies understand the regulations of what can be protected and how within their respective countries. Companies must obtain signed, legally binding agreements with all employees and outside consultants, assigning any and all such intellectual property rights to the company. In the absence of such understandings and agreements, companies jeopardize their ownership of valuable intellectual property.

Protecting the intellectual property : After creation, the second stage involves deciding the countries in which one wishes to seek protection. This decision is focused on monetary consideration and thus, needs careful analysis. To make and implement this decision, a company must be aware of the different national intellectual property laws. Most of the legal issues in this stage can be clarified through professional counseling.

Utilising and exploiting intellectual property: Utilizing and strategically exploiting the company's intellectual property is the third stage that may involve licensing agreements. These arrangements can subsequently lead to antitrust actions provided they contain restrictive clause, which is potentially very severe. Although both intellectual property and anti-trust handling may share the common purpose of promoting innovation and enhancing consumer welfare, their methods are opposite. Intellectual property law grants monopolies to encourage advance in science and art, and is not dictated by price, while antitrust policy generally prohibits monopolies in order to enhance economic efficiency.

Enforcing the intellectual property : The fourth stage i.e., the enforcement of intellectual property is the most important stage in the lifeline of intellectual property. This stage prevents others from unauthorized utilization and exploitation of the protected property. The last stage lasts for the duration of the protection.

Legal issues arise at each of the four stages of the intellectual property life cycle stated above. A company must be aware of all of these legal issues, in order to protect its intellectual property and ensure that it does

not infringe upon another's intellectual property rights. Only if a company can successfully navigate the four stages of the intellectual property life cycle, it can hope to remain competitive amongst the companies that operate at the cutting edge of technology.

TRADE SECRETS

As mentioned earlier, a trade secret is a confidential practice method, process, design, or other information used by a company to compete with other businesses. Generally, it has been stated that any information that can be used in the operation of a business or other enterprise and that is sufficiently valuable to afford an actual or potential economic advantage over others is a trade secret.

The precise language by which a trade secret is defined varies by jurisdiction (as do the precise types of information that are subject to trade secret protection). However, there are three factors that (though subject to differing interpretations) are common to all such definitions: a trade secret is some sort of information that (a) is not generally known to the relevant portion of the public, (b) confers some sort of economic benefit on its holder (which means this benefit must derive specifically from the fact that it is not generally known, not just from the value of the information itself), and (c) is the subject of reasonable efforts to maintain its secrecy.

Trade secrets are not protected by law in the same manner as trademarks or patents. Probably one of the most significant differences is that a trade secret is protected without disclosure of the secret. A trade secret might be a patentable idea but not always. Unlike patent, a trade secret does not have to pass the test of novelty; nevertheless the idea should be somewhat new, unfamiliar to many people including many in the same trade.

Trade secrets are not registered like other forms of intellectual property and are not creatures of statutes. Instead, the judicial system of each country determines the requirements for obtaining trade secrets protection. In India, trade secrets are not covered under any law. The TRIPS Agreement under Article 39 provides protection to trade secrets in the form of "undisclosed information" providing a uniform mechanism for the international protection of trade secrets. Such information must be a secret, i.e. not generally known or readily accessible to person within the circles that normally deal with all kinds of information in question. Also, the information must have commercial value because it is secret and the information must be subject

to reasonable steps by its owners to keep it secret. TRIPS Agreement requires the member countries to provide effective remedies for trade secret misappropriation including:

- injunctive relief;
- damages; and
- provisional relief to prevent infringement and to preserve evidence.

Trade secrets are by definition not disclosed to the world at large. So long as trade secret remains a secret, it is valuable for the company. Once the information enters the public domain, it is lost forever. Therefore, companies should take every precaution to keep the information secret. Instead, owners of trade secrets seek to keep their special knowledge out of the hands of competitors through a variety of civil and commercial means, not the least of which is the employment of confidentiality agreements and/or nondisclosure agreements. In exchange for the opportunity to be employed by the holder of secrets, a worker will sign an agreement not to reveal his prospective employer's proprietary information. Often, he will also sign over rights to the ownership of his own intellectual production during the course (or as a condition) of his employment. Violation of the agreement generally carries stiff financial penalties, agreed to in writing by the worker and designed to operate as a disincentive to going back on his word. Similar agreements are often signed by representatives of other companies with whom the trade secret holder is e.g. engaged in licensing talks or other business negotiations.

Trade secret protection can, in principle, extend indefinitely and in this respect offers an advantage over patent protection, which lasts only for a specified period. It is equally possible that a company may decide not to patent as for instance formula for Coca-Cola.

Companies often try to discover one another's trade secrets through lawful methods of *reverse engineering* on one hand and less lawful methods of industrial espionage on the other. Acts of *industrial espionage* are generally illegal in their own right under the relevant governing laws, of course. The importance of that illegality to trade secret law is as follows: if a trade secret is acquired by improper means (a somewhat wider concept than "illegal means" but inclusive of such means), the secret is generally deemed to have been misappropriated. Thus if a trade secret has been acquired via industrial espionage, its acquirer will probably be subject to legal liability for acquiring it improperly. (The holder of the trade secret is nevertheless obliged to

protect against such espionage to some degree in order to safeguard the secret. As noted above, under most trade secret regimes, a trade secret is not deemed to exist unless its purported holder takes reasonable steps to maintain its secrecy.)

The test for a cause of action for breach of confidence in the common law world is set out in the case of *Coco v. A.N. Clark (Engineers) Ltd.*, (1969) R.P.C. 41 :

- the information itself must have the necessary quality of confidence about it;
- that information must have been imparted in circumstances imparting an obligation of confidence;
- there must be an unauthorized use of that information to the detriment of the party communicating it.

The “quality of confidence” highlights the fact that trade secrets are a legal concept. With sufficient effort or through illegal acts (such as break and enter), competitors can usually obtain trade secrets. However, so long as the owner of the trade secret demonstrates that reasonable efforts have been made to keep the information confidential, the information remains a trade secret and is legally protected as such. Conversely, trade secret owners who do not demonstrate reasonable effort at protecting confidential information, risk losing the trade secret even if the information is obtained by competitors illegally. It is for this reason that trade secret owners shred documents and do not simply recycle them. Presumably an industrious competitor could piece together the shredded documents again. Legally the trade secret remains a trade secret because shredding the document is considered to have kept the quality of confidence of the information.

INTERNATIONAL TRADE AND TRADE SECRETS

In technology transfer a trade secret may be far more valuable than a patent. Some times a trade secret is not really a secret and may not be of much value either. In a technology package some part is usually unprotected information, even so the best way of obtaining this unprotected information is to buy from the suppliers. Companies must be assured trade secret protection, which they are enjoying in their respective countries under the international licencing agreements. As mentioned earlier, the value of a trade secret lies in its secrecy. If a company cannot ensure protection of its trade secrets in a foreign country, it will not do business

in that country. Every company should therefore, take some important measures to protect its trade secrets.

A checklist for the identification of potential trade secrets owned by a manufacturing company has been devised which *inter alia* includes:

- (i) technical information/research and development;
- (ii) proprietary technology information;
- (iii) proprietary information concerning research and development;
- (iv) formulas;
- (v) compounds;
- (vi) prototypes;
- (vii) processes;
- (viii) laboratory notebooks;
- (ix) experiments and experimental data;
- (x) analytical data;
- (xi) calculations;
- (xii) drawings- all types;
- (xiii) digrams- all types;
- (xiv) design data and design manuals;
- (xv) R&D reports-all types;
- (xvi) R&D know-how and negative know-how (i.e. what does not work);
- (xvii) Production/ process information;
- (xviii) Proprietary information concerning production/ process etc.

Some experts suggest that it may be prudent for the companies to conduct an intellectual property audit to identify the protectable business information. This will help the companies to assess the value of the information useful for their business. The intellectual property audit is the starting point for the development of a trade secrets protection programme as company's portfolio of trade secrets is constantly changing. Some information becomes obsolete, new information is created which is extremely valuable and may be protected.

Once the audit is complete, the next step is to determine appropriate level of security necessary to protect different types of trade secret. There are six factors which need to be taken into consideration while determining whether information owned or used by a company is a trade secret in terms of the necessary

level of security to ensure adequate protection of those trade secrets. These are:

- The extent to which the information is known outside the company.
- The extent to which the information is known by employees and others involved in the company.
- The extent of measures taken by the company to guard the secrecy of the information.
- The value of the information to the company and the competitors.
- The expenditures by the company (time, money, effort) in developing the information.
- The ease or difficulty with which the information could be properly acquired or duplicated by others.

In the race of global competition, the future of a nation depends on the efficiency of its industry and the efficiency of the industry in turn equally depends on the strong protection of its intellectual property. Strong intellectual property is vital for corporates who use their creative and other resources to strive for excellence in the global competitive environment thereby making better things for better living. By the same token it may be pointed out that the potential value in actively acquiring, assessing and protecting intellectual property interests in terms of attracting outside investors, establishing the company's leadership position in a field, and obtaining a possible stream of licensing revenue is

often overlooked or underestimated by companies. So if companies incorporate an Intellectual Property Management System, it will enhance companies worth and provide them with appropriate knowledge of their intellectual property. Moreover, this will also assist them in deciding as to which intellectual property rights are to be acquired and maintained and how best to manage the intellectual property assets of a company. Mention must be made that intellectual property laws cannot remain static in a world where economic development is becoming increasingly technology-based. Intellectual property laws are going to be more stringent and stricter in the days to come, offering more opportunities and challenges. It is therefore very important that every business be aware of issues relating to intellectual property and take concrete steps towards building an effective Intellectual Property Portfolio for strategic competitive advantage.

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PROFESSIONALLY MANAGING THE INTERNATIONAL FINANCING FOR INDIA INC

SONIA BAIJAL *

INTRODUCTION

India Inc. though slowly but surely embarked on the global path leading to the emergence of the Indian multinational companies. An acquisition led strategy coupled with strong performance has become a sustainable strategy for Indian companies going global. The Indian corporate sector has indeed taken a giant leap particularly after globalisation and deregulation. Known only for spices, cotton and cheap labour India has completely transformed its image into one of the fastest growing economies of the world- fourth in terms of purchasing power parity and tenth most industrialized economy. The metamorphosis to globally competitive and fastest growing economy has been fuelled by meticulous strategy and vision of Indian corporate sector and commitment by the Government in providing conducive environment for corporates to develop and grow.

With each passing day, Indian businesses are acquiring companies abroad, becoming world popular suppliers and are recruiting staff cutting across nationalities. This may be exemplified by the fact that Tata Motors sells its passenger-car Indica in the UK through a marketing alliance with Rover and has acquired a Daewoo Commercial Vehicles unit giving it access to markets in Korea and China. Ranbaxy is the ninth largest generics company in the world generating an impressive 76 percent of its revenues from overseas. Asian Paints is among the 10 largest decorative paints makers in the world with manufacturing facilities across 24 countries. Bharat Forge a small auto components company is the world's second largest forgings maker. Essel Propack is the world's largest manufacturers of lamitubes - tubes used to package toothpaste, with 17 plants spread across 11 countries and a turnover of Rs 609.2 crore for the year ended December 2003. The company commands a staggering 30 percent of the 12.8 billion-units global

tubes market. About 80 percent of revenues for Tata Consultancy Services comes from overseas operations. Infosys has 30 marketing offices across the world and 26 global software development centres in the US, Canada, Australia, UK and Japan.

As far as acquisition led strategies of Indian companies are concerned - the Reliance Industries acquired Flag Telcom Bermuda for US \$ 212 million, and Trevira, Germany for US \$ 95 million; Tata Motors acquired Daewoo, Korea for US \$ 118 million; Infosys Technologies acquired Expert Information Services, Australia for US \$ 3.1 million; Wockhardt acquired CP Pharmaceuticals UK for US \$ 18 million; Cadila Health acquired Alpharma SAS France for US \$ 5.7 million; Hindalco acquired Straits Ply, Australia for US \$ 56.4 million; Wipro acquired Nerve Wire Inc. US for US \$ 18.5 million; Aditya Birla acquired Doshiquiao Chem, China for US \$ 8.5 million; and United Phosphorus acquired Oryzalin Herbicide, US for US \$ 21.3 million.

Having explained the one side of the coin, let us now consider the other one. The process of economic liberalization has led the markets for consumer products ranging from soft drinks to ice creams to washing machines to refrigerators taken off fuelled by increasing purchasing power and a growing middle class. Indian firms in these industries enjoy tremendous opportunities for long-term growth in sales and profits, for victory on an unprecedented scale. Unfortunately, many Indian firms are managing to snatch defeat from the jaws of victory as they have to compete with MNCs who have deep financial muscles.

In this context, Indian companies often argue that they cannot compete against MNCs because the MNCs command much larger resources and have strong financial backing. It is argued that the MNC can afford to and does lose money for a long time in order to

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develop its long-term competitive position and that the Indian firm cannot sustain.

There are series of problems emanating from this argument. Given the size and efficiency of capital markets, competitive advantage does not come from the accessibility of capital, rather capital flows to those firms with a competitive advantage.

In the past, Indian capital markets were quite thin and meager and access to capital was rather restricted. In that environment, access to capital was a source of competitive advantage. This is one of the major reasons why conglomerates thrived in India. However, today capital markets in India are quite large and much more efficient compared to its earlier days. Indian firms need to better utilize local and foreign capital markets and the firms need to convince the capital markets that they have a strategy for building, sustaining and exploiting competitive advantage which will help them compete MNCs and result in earning their return on investment greater than the cost of capital.

Many Indian companies are themselves responsible for the lack of capital to sustain a fight against MNCs. Indian firms tend to be too diversified and are thus spread out too thinly in terms of financial capital and managerial resources. Indian firms need to restructure and focus their capital on fewer industries where they have a competitive advantage and can compete aggressively in those industries. Indian companies are also probably overestimating the deep pockets of the MNCs. A multinational company may have more capital resources than the Indian company but since it is competing in several countries it cannot concentrate all its resources on India alone.

In this direction, the Government has taken a number of policy initiatives to allow Indian companies to raise resources from the International markets. Consequently raising funds through Euro Issues has become popular with the companies and investors both. Indian companies found this route very attractive and today more and more companies are trying this avenue to raise funds. Two principal forms of international offering made by companies for tapping the international capital markets are Foreign Currency Convertible Bonds (FCCBs) and Equity Shares through Depository Receipts.

FOREIGN CURRENCY CONVERTIBLE BONDS

The FCCBs which are unsecured, carry a fixed rate of interest and an option for conversion into a fixed number of equity shares of the issuer company. Interest and redemption price (if conversion option is not

exercised) is payable in dollars. FCCBs can be denominated in any freely convertible Foreign Currency. Foreign investors also prefer FCCBs because of the Dollar denominated servicing, the conversion option and, the arbitrage opportunities presented by conversion of the FCCBs into equity at a discount on prevailing Indian market price.

EQUITY SHARES THROUGH DEPOSITORY RECEIPTS

Depository Receipt on the other hand is a negotiable instrument evidencing a fixed number of equity shares of the issuing company generally denominated in US dollars. Depository Receipts are commonly used by those companies which sell their securities in international market and expand their shareholdings abroad. These securities are listed and traded in International Stock Exchanges. These can be either American Depository Receipts (ADR) or Global Depository Receipt (GDR).

ADR Vs. GDR

There are several types of ADR, which require different level of disclosure of information and compliance with the regulations of the Securities Exchange Commission (SEC). However, the most important distinction of ADRs is that some categories of ADR allow the company to raise capital in the US, while others simply make it easy for US investors to buy and trade in existing shares. GDRs are often launched for capital raising purposes and are generally either a Rule 144(a) ADR or a Level III ADR, depending on whether the issuer aims to tap the private placement or public US markets. GDRs are generally denominated in US dollars, but may be denominated in any currency. They represent the underlying shares in same manner as ADRs, allow foreign investors to trade in the issuing company's stock without the problems associated with custody and settlement in foreign markets.

The Depository Receipts indeed offer investors a convenient means of holding foreign shares; simplify the trading and settlement of foreign equities; offer lower trading and custody costs as compared to shares bought directly in the foreign market; and as the ADRs, and normally GDRs too, are denominated in US dollars, the dividend payments on the underlying shares are converted into US dollars by the depository bank. These features minimise foreign exchange problems for investors.

ADR provides Indian company a simple means of diversifying a company's shareholder base and accessing the important US market; and may increase the liquidity

of the underlying shares of the issuer. An ADR helps to increase a Indian company's visibility and name recognition in the important US investor community. It is simple way of diversifying the company's shareholder base and of tapping the global capital markets. It allows capital raising on a scale which might prove impossible in the local market

CLASSIFICATION OF DEPOSITORY RECEIPTS

The depository receipts may be classified into capital raising and non-capital raising structures. The selection of a particular class of depository receipt depends on the requirements of the issuer, the features of the issuer's domestic market and investor attitudes.

(I) NON CAPITAL RAISING DEPOSITORY RECEIPTS

Non-capital raising ADR/GDR may further be classified under sponsored Level I and sponsored level II. There is also another type of Depository Receipts which are known as unsponsored.

A Level I sponsored ADR is the easiest and least expensive means for a company to provide for issuance of its shares in ADR form. These are initiated by the issuer and involve the filing of registration statement, but allow for exemption from full SEC reporting requirements. The issuer has a certain amount of control over the ADRs since a depository agreement is executed between the issuer and one selected depository bank. However, Level I ADRs can only be traded over-the-counter and cannot be listed on a national exchange in the US.

A sponsored Level II ADR must comply with the SEC's full registration and reporting requirements. The issuer is also required to comply with the SEC's other disclosure rules, including submission of its annual report prepared in accordance with US Generally Accepted Accounting Principles (GAAP). Registration allows the issuer to list its ADRs on one of the three major national stock exchanges, namely the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), or the National Association of Securities Dealers Automated Quotation (NASDAQ) each of which has its own reporting and disclosure requirements.

Level II sponsored ADR are initiated by Indian company to give US investors access to their stock in the US. A depository agreement is signed between the issuer and a depository bank, which defines the responsibilities of the depository and

include responding to investor enquiries, mailing annual reports and other important material to shareholders and maintaining shareholder records.

Sponsored Level II ADR is more attractive to US investors because these ADRs may be listed on one of the major US exchanges. This raises the profile of the ADR to investors, thus increasing the liquidity and marketability of the securities. Listing and registration also enhance the issuer's name recognition in the US and the requirements of disclosure regulations for large investors enable the issuer to monitor the ownership of its shares in the US.

(II) CAPITAL RAISING DEPOSITORY RECEIPTS

These Depository Receipts can further be categorized into sponsored Level III, Rule 144 (A) ADR (also known as Restricted ADRs).

Sponsored level III ADRs are similar to Level II ADRs as the issuer company initiates the ADR, deals with one depository bank, lists on one of the major US exchanges, and files registration statements with the SEC. The major difference is that a Level III program allows the issuer to raise capital through a public offering of ADRs in the US.

Level III ADR permits public offerings of ADRs in the US which can be used for a variety of purposes, for example the raising of capital to finance acquisitions or the establishment of an Employee Stock Ownership Plan (ESOP) for the issuer's US subsidiary.

Rule 144(a) ADRs, or Restricted ADRs (RADRs) are simply privately placed depository receipts which are issued and traded in accordance with Rule 144(a). This rule was introduced by the SEC in April 1990 in part to stimulate capital raising in the US by non-US issuers. Some of the former restrictions governing resale of privately placed securities or restricted securities have been lifted under Rule 144(a), provided the sale is made to qualified institutional buyers with the aim of adding liquidity to the private placement market.

Indian companies have easy access to the US equity private placement market and may thus raise capital through the issue of restricted ADRs without conforming to the full SEC registration and reporting requirements. Additionally the cost of issuing Rule 144(a) ADRs is considerably less than the cost of initiating a Sponsored Level III ADR.

RADRs provide a cheaper means of raising equity

capital than through a public offering and they can be issued more easily and quickly. RADRs can be launched on their own or as part of a global offering. However, RADRs cannot be created for classes of share already listed on a US exchange. RADRs can only be sold in the US to Qualified Institutional Buyers. Although there are in excess of 4000 potential Qualified Institutional Buyers, the RADR market is not as liquid as the public US equity market.

ADR/GDR/FCCB – REGULATORY FRAMEWORK

With effect from 1 June 2000, foreign investment in Indian securities is regulated by the FEMA and the rules, regulations and notifications made thereunder. A person resident outside India is allowed to transfer any security of an Indian company or any other security to an Indian resident subject however to the prescribed terms and conditions.

The RBI has issued the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 to regulate the issue of Indian securities including Global Depository Receipts to persons resident outside India and the transfer of Indian securities by or to persons resident outside India. The RBI has also issued the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000 permitting an Indian entity to issue securities to a person resident outside India or record in its books any transfer of security from or to such person in the prescribed manner.

The Government through Issue of Foreign Currency Convertible Bonds and Ordinary shares (Through) Depository Receipt Scheme, 1993, allowed Indian corporates to issue FCCBs. This Scheme has been amended from time to time and certain relaxations in the guidelines have also been notified. The relevant regulations provide that an Indian company may issue FCCBs to recognised Lenders which include, *inter alia*, international banks, international capital markets and multilateral financial institutions subject to the approval of the RBI in certain cases. Any Indian company issuing such bonds is required to comply with certain reporting requirements prescribed by the RBI. The relevant regulations provide the following:

- (i) An Indian corporate can raise funds up to US \$500 million under the automatic approval route, and above US \$500 million with the approval of the RBI. FCCBs up to US \$20 million are required to have a minimum average maturity period of three years and FCCBs above

U.S.\$20 million and up to US \$500 million are required to have a minimum average maturity of five years.

- (ii) The issue of FCCBs is subject to the foreign direct investment regulations.
- (iii) Public issue of FCCBs is to be made through reputable lead managers.
- (iv) In case of private placement of the FCCBs, the placement has to be made with banks or multilateral and bilateral financial institutions, or foreign collaborators or foreign equity holders having a minimum holding of 5 per cent, in the issuing company. However, the private placement of FCCBs with unrecognised sources is prohibited.
- (v) Prepayment of FCCBs up to US \$100 million is permitted subject to compliance with the minimum average maturity period.
- (vi) FCCBs cannot be issued with attached warrants.
- (vii) The “all in cost” ceiling for the issue of FCCBs having a minimum average maturity period of three years up to five years should not exceed six month LIBOR plus 2 per cent, and, in the case of FCCBs having a minimum average maturity period of more than five years, should not exceed six month LIBOR plus 3.5 per cent.
- (viii) FCCB proceeds are to be used for investment purposes (such as import of capital goods, new projects, modernisation/expansion of existing production units) in deal sector-industrial sector including small and medium enterprises and the infrastructure sector in India and may also be used in the first stage acquisition of shares in a disinvestment process or in the mandatory second stage offer to the public under the Government of India’s disinvestment programme for shares of a public sector undertaking, overseas direct investment in joint ventures, wholly-owned subsidiaries or the expansion of existing joint ventures or wholly-owned subsidiaries. FCCB proceeds are not permitted to be used for working capital purpose, general corporate purpose or for repayment of existing rupee loan.
- (ix) FCCB proceeds may not be used for lending and investment in stock markets and real estate (other than permitted development of integrated townships);
- (x) Proceeds from the issue of the FCCBs after

deduction of the amounts equal to the commissions, fees etc. (provided that such amounts do not exceed the prescribed ceiling) are to be parked overseas until actual requirement in India.

- (xi) Issue-related expenses should not exceed 4 per cent of issue size for public issues and 2 per cent for private placements.

PROCEDURE FOR ISSUE OF ADRs/GDRs/FCCBs

1. Approvals

The issue of ADRs/GDRs/FCCBs requires the approvals of Board of Directors, Shareholders, Ministry of Finance, Ministry of Company Affairs, Reserve Bank of India, Stock Exchange and Financial Institutions.

2. Appointment of Intermediaries

ADRs/GDRs/FCCBs normally involve a number of intermediaries including lead Manager, Co-Manager, Overseas Depository Banks, Listing Agent, Legal Advisor, Printer, Auditors and Underwrites.

3. Principal Documentation

The principal documents required to be prepared include subscription agreement, Depository Agreement, Custodian Agreement, Agency Agreement and Trust Deed.

4. Pre and Post Launch – Additional Key Actions

Apart from obtaining necessary approvals, appointment of various agencies and proper documentation, additional key actions necessary for making the issue of ADR/GDR/FCCB a success, include

- (i) Constitution of a Board Sub-Committee
- (ii) Selection of Syndicate Members
- (iii) Constitution of a task force for due diligence
- (iv) Listing
- (v) Offering Circular
- (vi) Research Papers
- (vii) Pre-marketing
- (viii) Timing, pricing and size of the issue
- (ix) Roadshows
- (x) Book Building and pricing of the issue
- (xi) Closing of the issue
- (xii) Allotment

- (xiii) Investor Relation Programme and
- (xiv) Quarterly Statement

The discussion in the preceding paragraphs makes it amply clear that the Indian companies raising capital through International offerings have to meet not only elbow disclosure requirements but also to make exhaustive arrangements before finally launching of the issue. In fact Indian companies have to meet international corporate governance standards to enhance their credibility in making themselves truly world class organizations.

CONCLUSION

The government's endeavour to integrate the economy with its liberalizing policy measures and rationalisation of various laws has resulted in the globalisation of the Indian economy i.e. opening up of the Indian capital markets for the foreign entrepreneurs and investors and creating new vistas for the Indian entrepreneurs and investors by allowing them the access to international capital market. The real challenge lies not that the issue gets through well but also at an adequate price. So companies have to ensure efficient management practices, evolve a good information and reporting system, induct the aspects of total quality management so that they can win the confidence of the foreign investors that the issuers are genuine competent and reliable. The role of Company Secretaries is well recognized in the management and compliance of Securities Laws. In addition Company Secretaries have been playing a very important role in the issue of securities and in capital markets by advising the management from planning to management of Public Issues, Right Issues of shares and other securities including ADRs and GDRs. In view of challenges emerged due to presence of MNCs, the Company Secretary's responsibilities have increased in guiding the managements of Indian companies in accessing the capital markets in various countries and issue of Indian securities thereby making Indian companies strong enough to face the challenges of competition.

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INVESTMENT IN R & D BY FOREIGN COMPANIES — TAX ASPECTS

YOGINDU KHAJURIA *

INTRODUCTION

When we talk of Global Competition, the questions which come to our mind, are:

What is it? Why we should go for it? How do we go for it? What is the need?

Then we strive to look for valid reasons why big business leaders with real world, hard-hitting insight, find it necessary to take full advantage of the opportunities around the globe and establish a successful worldwide presence. This opens door for us to jump into competition so as to meet the big Giants. This is how we begin to globalize functions and build our capacities and skills to recognize the opportunities worldwide.

Thus, global vision serves as the basis for building an internationally competitive team composed of people who not only possess the combination of direct experience and cross-border & cross-cultural competencies to do business in all markets of the world but also who can facilitate the transfer of ideas in other parts of the world.

Global leaders in companies of all sizes and industries are not intimidated by the prospect of competing on a global level. Becoming global is really to do with the attitude and resolve of a company's leadership to break loose of its bond of being domestically or regionally bound.

India is considered as an attractive destination for foreign companies in view of its strong economic growth, great domestic demand followed by low interest rates and a progressive government policy.

There are a large number of investors who are keen to participate in India's growth. A progressive investment policy can bring fresh investments, whereas the loss of confidence in our ability to push through reforms will

be a serious cause for concern. As long as India continues to offer long term higher-growth-oriented policies, inflows from foreign investors will continue to swell. The foreign investors keenly watch the pace of deficit reduction, privatization and tax reforms, including plans to introduce a value added tax with effect from April 1, 2005. We need to re-assure the investors that we are committed to reforms in the areas of duty rationalization, infrastructure creation, opening up of new sectors for investments and relatively better labour policies. Another factor that plays an important role is the pull of the domestic demand.

The implementation of economic reforms and the consequent globalization, has led to a phenomenal increase in the number of non-residents and foreign companies doing business in India. One of the main reasons for this increase lies in India being an attractive market for multinational companies than other countries. Marketing here can be easily done through thousands of privately owned retailers from big departmental stores to corner shops. In the present era, the greatest challenges and obstacles that are faced by multinational companies are, political and cultural constraints, resource and logistical constraints, protectionism.

For the purpose of promoting foreign investments, the Hon'ble Minister of Finance in his Budget Speech for the year 2004 announced the setting up of Investment Commission for promoting foreign investments in India. In this regard he said, "It is my goal to make the environment in India attractive for investors. In order to achieve that goal, I propose to establish an Investment Commission. The Commission will have the broad authority of the Government to engage, discuss with and invite domestic and foreign businesses to invest in India. It will be chaired by an eminent person. The Foreign Investment Promotion Board (FIPB) has played a useful role, and even now it serves as a one-stop centre for securing the nod of

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different ministries and departments to a proposed investment. Government believes that many of the functions of FIPB could be put on the automatic route, and leave FIPB as a one-stop service centre and facilitator. The function of wooing domestic and foreign investors will be performed by the proposed Investment Commission".

The McKinsey survey of global executives revealed that around forty four per cent of respondents from large companies preferred to increase their investments in India in the areas like, heavy industry, banking & finance and consumer goods besides Information Technology Sector. Also fifty eight per cent of these global executives felt that India is a huge source of talent and a better destination than China for setting up of Research and Development Units.

Various fiscal incentives and support measures are announced by the Government through the Union Budget every year to encourage Research and Development in industry and to increase utilization of locally available Research and Development options for industrial development including new incentives encouraging investments in Research and Development by industry.

Keeping in view the interest of the foreign investors in research and development activities in India, this is the right time to accelerate implementation of changes that would encash and convert this in to substantial jump in foreign investments.

BUSINESS OPPORTUNITIES IN INDIA FOR FOREIGN ENTREPRENEURS – TAX AND LEGAL ISSUES

While looking at the prospect of doing business in India it would be prudent for foreign entrepreneurs to see the various options available to a Non Indian company to invest in India. Since 1991 India has undergone a sea change in its outlook towards foreign investment and global collaboration. It's no wonder that research and development activities have really made it possible to accelerate India's outward push.

Once the companies decide to invest in India, the next question shall naturally be how to set up operations? There are primarily two ways to begin the work:

- (a) To establish their own set up;
- (b) Outsource the work to a local company.

1. To establish their own set up

Many foreign investors prefer to have their own set up in India. This gives them better control over

management of the organization. It is the best guarantee that the company's processes are being followed. Furthermore, this is preferable, especially if the volume of work is large or the work is sensitive in nature.

However, there are also certain disadvantages to this approach. One is regarding flexibility. Often these branches or subsidiaries are bound by the policies of the parent company and this may make it unwieldy when it comes to Indian legal and cultural framework. Secondly, management of a remote set up is always more difficult, especially where the work involved is of intermittent type and is to be one in small volumes.

Generally, the types of foreign investments prevalent in India are:

- (a) Branch Office
- (b) Hundred percent Subsidiary
- (c) Joint Venture Companies
- (d) Acquiring Existing Indian companies

(a) Branch office

Opening of branch offices in India is really simple. The corporates are allowed to open a branch office only if they engage in manufacturing or trading for the activities like:

- Representing their companies in various matters in India e.g., acting as buying/selling agents in India, etc.;
- Conducting research work in which the parent company is engaged provided the results of the research work are made available to the Indian companies;
- Undertaking export and import trading activities;
- Promoting the possible technical and financial collaborations between the Indian companies and overseas companies.

Under this type of set up, they shall not be allowed to make any sales in India for any of their products or services.

(b) Hundred percent Subsidiary (Wholly Owned Companies)

If the corporate decides to hand over control to the local management or wish to sell their products in India then this option is looked in

to. For example, in case of software industry, the Government of India allows up to 100% ownership by the Foreign Investor. Also, if they desire to set up their office in an Export Processing Zone (EPZ), Software Technology Park (STP) or Electronic Hardware Technology Park (EHTP), then they shall automatically be given permission for 100% ownership. The catch though is that they shall be required to export at least 75% of the final output out of India. Many States have at least one of these Parks. Automatic approvals are given by the Secretariat for Industrial Approval for setting up 100% Export Oriented Units (EOU). These zones are designed to provide internationally competitive infrastructure facilities and duty-free and low cost environment. Various monetary and non-monetary incentives are also granted which include import duty exemption, complete tax holiday, decentralized "single window clearance," etc.

Establishing units in EPZs or STPs have the following advantages:

- Duty Free imports;
- Tax free income;
- Readymade infrastructure;
- Housing and living facilities (in some cases).

(c) *Joint Venture Companies*

This is a common form of investment, because it allows the Foreign Investor and the Indian partner to do what each wants. The foreign partner brings in technology, systems and products and the Indian partner takes care of Human resources, marketing, legal and tax issues. This is a special favorite for foreign companies just moving into India, since it gives them the distribution channel to get sales moving quickly.

However, over the long term they may prefer to move to a 100% subsidiary, to establish greater control. This is commonly done by means of stock buyouts or fresh investments. Both Wholly owned Companies and Joint ventures may be registered as Private Limited Liability (Pvt. Ltd.) or Public Limited Liability (Public Ltd.) Company.

(d) *Acquiring Existing Indian Companies*

The foreign investor corporates also have the option of acquiring a company already existing

in India. Such acquisition could take place through the issue of fresh capital and /or transfer of shares of an existing Indian company to the foreign investor with the effect of transferring control. Shares of an Indian company could be acquired from another foreign investor. This will give them the advantage of a readymade set up. The Foreign Exchange Management Act (FEMA) makes it necessary that Reserve Bank of India (India's Federal Reserve Bank) permission be taken prior to acquisition of shares in an Indian company by a foreign investor. Similar permission is required in case of transfer of shares by them to a person resident in India. Either the transferor or the transferee shall apply for permission.

Corporate Tax and other Incentives

The corporate income tax effective rate for domestic companies is 35% while the profits of branches in India of foreign companies are taxed at 45%. Companies incorporated in India (any of India's set up other than a branch) even with 100% foreign ownership, are considered domestic companies under the Indian laws.

Other incentives include :

- Tax Holiday;
- Exemption from taxes on exports earnings even after the period of tax holiday;
- Exemption from Central and State taxes on production and sale;
- Permission to install machinery on lease;
- Freedom to borrow self-liquidating foreign currency loans at the prime rate of interest;
- Inter-unit transfers of finished goods among exporting units.

2. Outsource the work to Local Company

The other option is to completely outsource your work to Indian companies. This has its own advantages. For example —

For intermittent jobs, it may be advisable to pay only when they have work. Also if the volume of work were small, it would always be difficult to achieve economy of scale. Outsourcing ensures that while the corporates may not be the best in a certain

area, they are giving the work to someone who is really good at it. That leaves them to focus on what they do best. Many Indian companies do a lot of business with International clients, so they would often be able to bring in expertise and advice from their earlier work. Lastly they have no legal hurdles to overcome when they outsource.

Due to these incentives many companies prefer to get their work outsourced, leaving them to do the things that directly impact their success.

Through the successive industrial policies and other investor friendly measures, India has been striving to accelerate the flow of Foreign Investments into Indian industrial sector. It has also been extremely conscious about attracting more investments into the backward areas with the aim of achieving equitable development of the country. The policies pursued by the country have resulted in promoting investment in general, diversification of industries and generation of employment opportunities besides Foreign Investments. There is a need for structural change in the economy, with diversification of the research & development sector and the contribution of the industrial sector growing internationally, to take a comparatively significant place in the world's overall economy.

FISCAL INCENTIVES FOR RESEARCH AND DEVELOPMENT ACTIVITIES

Several fiscal incentives and other support measures announced from time to time to boost research & development activities in the country include :

- (i) Income tax relief on research and development expenditure.
- (ii) Weighted tax deduction for sponsored research.
- (iii) Customs duty exemption.
- (iv) Tax holiday for commercial research and development companies.
- (v) Customs duty waiver on goods produced based on indigenously developed technologies and duly patented in any one of the countries in European Union and USA or Japan or in both.
- (vi) Accelerated depreciation allowance on new plant and machinery setup based on indigenous technology.
- (vii) Price control exemption on domestic research and development based bulk drugs.

- (viii) Increasing the number of national awards for outstanding research and development achievements and commercialization of public funded research and development.

WHAT IS SCIENTIFIC RESEARCH?

The term "scientific research" is defined in Section 43(4) of the Income Tax Act, 1961 as follows:

Scientific Research

- (i) means any activities for the extension of knowledge in the fields of natural or applied science including agriculture, animal husbandry or fisheries;
- (ii) includes all expenditure incurred for the prosecution, or the provision of facilities for the prosecution, of scientific research, but do not include any expenditure incurred in the acquisition of rights in, or arising out of scientific research;
- (iii) references to scientific research related to a business or class of business include—
 - (a) any scientific research which may lead to or facilitate an extension of that business or, as the case may be, all businesses of that class;
 - (b) any scientific research of a medical nature which has a special relation to the welfare of workers employed in that business or, as the case may be, all businesses of that class.

Accounting Standard 26 issued by the Institute of Chartered Accountants of India defines the term, "Research and Development" as-

"Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services prior to the commencement of commercial production or use".

EXPENDITURE ON SCIENTIFIC RESEARCH

If any dispute arises as to whether any activity constitutes scientific research or any asset is being used for scientific research, the Central Board of Direct Taxes shall refer the question to the prescribed authority. The prescribed authority as per Rule 6 of the Income Tax

Rules, 1962 is the Director General (Income-tax Exemptions) in concurrence with the Secretary, Department of Scientific and Industrial Research, Government of India. With effect from Assessment Year 2000-2001, the approval shall be granted by the Central Government instead of the prescribed authority. The application for the purpose is to be furnished by a scientific or industrial research organization or institution under Section 35 (1)(ii)(iii) in the prescribed Form No. 3 CF.

Part IV-A of the Constitution of India lays down certain fundamental duties, which include the duty of every citizen of India "to develop the scientific temper, humanism and the spirit of inquiry and reform" [Article 51-A (h)].

Realizing the key role of Science & Technology in the task of National Reconstruction, Economic Resurgence and Maintenance of National security of the Country, the Government of India under Science & Technology Policy-2001 enunciated the objectives which *inter alia* include, "to use science & Technology as a vehicle for international cooperation and collaboration and to promote the pooling and sharing of material and intellectual resources in order to achieve common goals".

With a view to accelerating scientific research, Section 35 of the Income tax Act, 1961 provides tax incentives. As per this section expenditure on scientific research may be broadly grouped under the following categories—

1. In-house research – It includes the following:
 - (a) revenue expenditure;
 - (b) capital expenditure;
 - (c) expenditure on an approved in-house research under Section 35(2AB).
2. Payment to outsiders—It includes the following—
 - (a) contribution to an approved scientific research association;
 - (b) contribution to approved national laboratories, etc.

Where the assessee company carries on scientific research and incurs revenue expenditure during the previous year, deduction is allowed for such expenditure only if the research relates to the business. This deduction is available only in respect of expenditure on scientific research related to the assessee's business and is limited to an amount certified by the prescribed authority.

It has been clarified in the case of *CIT v. National Rayon Corporation Ltd.* (1983) 140 ITR 143 (Bom) that for claiming deduction under Section 35(1)(i), it is not necessary that the research must have been carried by the assessee himself. The deduction can be claimed even if the research is carried on by some other person for and on behalf of the assessee. In *CIT v. Ciba of India Ltd.*, (1968) 69 ITR 692 (SC), the assessee, an Indian subsidiary of a Swiss company, made contributions to recoup the Swiss company for the expenditure on scientific research incurred by the latter. It was held by the Supreme Court that the payment made to recoup another person for expenditure on scientific research incurred by that other person, even if it might ultimately benefit the assessee, was not, unless such research was carried for and on behalf of the assessee, expenditure laid out or expended on scientific research related to the business of the assessee. Nonetheless, it was pointed out, the expenditure so incurred could be allowed as deduction under Section 37 as a revenue expenditure.

Likewise, where the assessee claimed a deduction on account of expenses incurred for research and the expenses were disallowed by the revenue on the grounds that such expenses constituted capital expenditure and that the research was not conducted by the assessee himself, it was held in *CIT v. Indian Oxygen Ltd.* (1978) 113 ITR 109 (Cal) on facts, that the amount in question was revenue in nature and was allowable under Section 37(1) of the Act.

Section 35(1) allows capital expenditure on scientific research where the expenditure is made for construction of building for scientific research, it can be allowed as and when it is incurred and does not have to await completion of the building as was pointed out in *CIT v. Rane Brake Linings Ltd.* (2002) 255 ITR 395 (Mad.). It has been held in *CIT v. Sundaram* 223 ITR 455 that the written down value of the machinery transferred to the scientific research and development cell of the company is expenditure 'incurred' during the year of transfer and is eligible for deduction under Section 35(1)(i).

The word 'incur' means 'to be liable to' and therefore, the expenditure is allowable in the year in which it is incurred and not in the subsequent year when the capital asset is brought into existence (*Belpahar v. CIT* 207 ITR 144).

Where the assessee does not himself carry on scientific research but makes contributions to the scientific research association, university, college or other institution for this purpose, a weighted deduction is

allowed of one and one-fourth times of any sum paid to a scientific research association or to a university, college or other institution provided that such association, university, college or institution is for the time being approved for the purpose of this clause by the Central Government by notification in the Official Gazette.

In *Tata Chemicals Ltd. v. CIT* (1992) 195 ITR 561 (Bom), contribution made to an association for research in a product manufactured by the assessee was disallowed on the ground that it was not an approved association under Section 35(1)(ii). However, there was no finding that it could be allowed under Section 35(1)(i). With respect to the alternative claim under Section 37, it was held that such claim cannot be disallowed as there was no clear finding that it was allowable under Sections 30 to 36 and accordingly the matter was remanded to examine allowability of the contribution under Section 35(1)(i) or Section 37.

There is nothing in the language of Section 35 which would justify the conclusion that the power to rescind an approval of a research association can be exercised with retrospective effect (*B.P. Agarwal & Sons Ltd. v. CIT* [1993] 71 Taxman 361 (Cal.)).

The scientific research association, university, college or other institution referred to in Section 35 (1) (ii)(iii) is required to make an application in the prescribed Form No. 3 CF to the prescribed authority for the purpose of grant of approval, or continuance thereof under these clauses.

The prescribed authority may, before granting approval, call for such documents (including audited annual accounts) or information from the scientific research association, etc. in order to satisfy itself about the genuineness of the activities of the research association, etc. Notifications issued by the prescribed authority under Section 35(1) (ii)(iii) shall at one time have effect for not more than three assessment years, including an assessment year or assessment year commencing before the date on which such notification is issued.

CAPITAL EXPENDITURE INCURRED BY AN ASSESSEE CARRYING ON SCIENTIFIC RESEARCH

Where the assessee incurs any expenditure of a capital nature on scientific research related to his business, the whole of such expenditure incurred in any previous year is allowable as deduction for that previous year. The following are some of the examples of capital expenses deductible under Section 35—

1. Expenditure on purchase of plants and equipments for laboratory and on purchase or

construction of a building for conducting research;

2. Expenditure on purchase of air conditioners for laboratory;
3. Expenditure on purchase of cars and buses which are used to transport employees engaged in scientific research—*CIT v. Smith Kline & French (India) Ltd.*, [1994] 77 Taxman 153 (Kar.) [a special leave petition of the Department has been dismissed by the Supreme Court on July 12, 1994 in SLP (Civil) No.14916 of 1994];
4. Expenditure incurred by the assessee on construction of approach road to its research and development laboratories (*CIT v. Sandoz (India) Ltd.*, [1994] 74 Taxman 225 (Bom));
5. Expenditure on air-conditioners, coolers, calculators and fans in the research wing and the cost of buses for transportation of research personnel (*CIT v. SmithKline Beecham*, 226 ITR 764; *CIT v. Smith Kline* 77 Taxmann 153);
6. Value of capital represented by work-in-progress and machinery in transit and under erection in the assessee's research division (*CIT v. H.M.T. Ltd.* (1993) 199 ITR 235 (Kar.)).

Capital expenditure on construction of building for scientific research is allowable under Section 35 even if the building is not completed. Expenditure on scientific research including capital expenditure is allowed under Section 35 in the year in which it is incurred. It is not necessary in the case of a building that it should have been completed and brought to use during the year as is necessary for purposes of entitlement to depreciation [*CIT v. Gujarat Aluminium Extrusions Pvt. Ltd.* (2003) 263 ITR 453 (Guj.)].

The expression, "incurred" in Section 35(2)(i) shall be understood in the context of the method of accounting followed by the assessee. Where the assessee, following the mercantile system of accounting, has transferred certain machinery and equipment forming part of the assessee's assets for the purpose of scientific research and development relating to the business of the assessee, the assessee was held entitled to deduction under Section 35(1)(iv), for Assessment Year 1975-76 on the written down value of the assets so transferred [*CIT v. Sundaram Fasteners Ltd.* (1997) 223 ITR 455 (Mad.)].

PRE-COMMENCEMENT PERIOD EXPENSES

As per Explanation(1) to Section 35(2)(ia) where any capital expenditure has been incurred before the

commencement of the business, the aggregate of such expenditure so incurred within the three years immediately preceding the commencement of the business, shall be deemed to have been incurred in the previous year in which the business is commenced.

The phrase, "incurred in any previous year" in Section 35(2)(ia) categorically lays down that the entire capital expenditure incurred in any previous year can be deducted for that previous year only. These words exclude the possibility of any confusion as to whether the capital expenditure incurred in any preceding year can be deducted in the previous year or not.

The aforesaid deduction is not available in respect of capital expenditure incurred on the acquisition of any land after February 28, 1984.

As observed by the apex court in *Laxminarayan v. Returning Officer*, AIR 1974 SC 66, the word "incurs" means actually spent. If the Legislature had intended that the capital expenditure on a capital asset could be carried forward to a subsequent year when the capital asset was finally brought into existence, there was no necessity for use of the expressions "in any previous year" and "for that previous year". The provisions of Section 35(2)(ia) make it abundantly clear that the expenditure in any previous year can be considered for that previous year only [*Belpahar Refractories Ltd. v CIT* (1994) 207 ITR 144 (Ori.)].

If the asset is sold without having been used for other purposes, sale proceeds or deduction allowed, whichever is less, is chargeable to tax as business income of the previous year in which the sale took place. The excess of sale proceeds over deduction allowed is, however, chargeable to tax as capital gains according to the provisions of Section 45. Section 35(1) allows capital expenditure on scientific research where the expenditure is on construction of building for scientific research, it can be allowed as and when it is incurred and does not have to await completion of the building as was pointed out in *CIT v. Rane Brake Linings Ltd.* (2002) 255 ITR 395 (Mad.).

It was clarified in *CIT v. Yamuna Digital Electronics (P) Ltd.* (1999) 230 ITR 717 (AP) that it is not necessary that the assets must be used "wholly and exclusively" for research and development as the words "wholly and exclusively" used for research and development are not used in Section 35.

Section 35 refers only to 'capital expenditure' and does not further require that the asset brought into existence by incurring such expenditure should have

been complete in all respects. The deduction is for the expenditure to the extent incurred. Expenditure incurred on ongoing construction of a building designed for housing the research wing is clearly capital expenditure and is deductible under this provision (*CIT v. Rane Brake Linings Ltd.* [2003] 126 Taxman 231(Mad.)).

There is no provision in the Act, which provides that if the assessee has acquired some assets for the business and after using some assets for business for some time, transfers them by mere entry from the business side to the research side, he can get the benefit of deduction under Section 35. In the absence of such a provision, the mere entry in the books of account from one head to the other head does not make the assessee eligible for deduction under Section 35. More so, for the purpose of depreciation if the assessee owns the asset it is enough, but for the benefit of allowance under Section 35, the assessee should incur expenditure for scientific research (*Multi Metals Ltd. v. CIT* [2002] 254 ITR 652/123 Taxman 466(Raj.)).

EXPENSES ON CONDUCTING SPECIFIC PROGRAMMES ON SCIENTIFIC RESEARCH

Any sum paid by an assessee to a National Laboratory or a university or an Indian Institute of Technology or a specified person for carrying out programmes of scientific research, approved by the prescribed authority, is eligible for weighted deduction of one and one-fourth times. Such contributions which qualify for weighted deduction shall not be entitled to any other deduction under the Act. "National Laboratory" has been defined to mean a scientific laboratory functioning at national level under the aegis of the Indian Council of Agricultural Research, the Indian Council of Medical Research or the Council of Scientific and Industrial Research, the Defence Research and Development Organisation, the Department of Electronics, the Department of Bio-Technology or the Department of Atomic Energy and which is approved by the prescribed authority for this purpose.

EXPENDITURE FOR PROMOTING IN-HOUSE RESEARCH AND DEVELOPMENT

A weighted deduction is allowed of an amount equal to one and one-fourth times of qualifying expenditure with effect from the Assessment Year 1981-82 (but only in respect of expenditure incurred upto February 29, 1984). Expenditure incurred by any taxpayer in an approved in-house research and developmental unit on carrying out any research programme, approved by the prescribed authority (i.e. Department of Science and Technology) having regard to the social, economic and

industrial needs of India, was qualified for weighted deduction provided the expenditure was incurred upto February 29, 1984.

EXPENDITURE ON IN-HOUSE RESEARCH AND DEVELOPMENT FACILITY

In order to encourage research & development in drugs, pharmaceuticals, electronic equipment, computers, telecommunication equipment, and chemicals, sub-section (2AB) of Section 35 was introduced by Finance Bill, 1997 providing for weighted tax deduction of a sum equal to one and one-fourth times of any expenditure incurred on scientific research (not being expenditure in the nature of cost of any land or building). The in-house Research and Development facilities of the companies engaged in the business of manufacturing or production of the above said items is required to be approved by the prescribed authority i.e. Secretary, DSIR. Also the company shall enter into an agreement with the prescribed authority for co-operation in such research and development facility and for audit of the accounts maintained for that facility.

Section 35(2AB) provides for a weighted deduction in respect of expenditure on in-house research and development facility subject to the following conditions:

1. The taxpayer is a company.
2. It is engaged in the business of bio-technology or in the business of manufacture or production of any drugs, pharmaceuticals, electronic equipments, computers, telecommunication equipments, chemicals or any other article or thing notified by the Board (i.e. manufacture or production of helicopter or aircraft or computer software).
3. It incurs an expenditure on scientific research and such expenditure is of capital nature or revenue nature (not being expenditure in the nature of cost of any land and building). From the Assessment Year 2002-03, the expenditure on scientific research in relation to drugs and pharmaceuticals shall include expenditure incurred on clinical drug trial, regulatory approval and filing an application for a patent.
4. The above expenditure is incurred on in-house research and development facility up to March 31, 2005.

In view of Section 43(4)(ii), references to scientific expenditure incurred on scientific research include all expenditure incurred for the prosecution, or the provision

of facilities for the prosecution of scientific research, but do not include any expenditure incurred in the acquisition of rights in, or arising out of, scientific research. In view of Section 43(4)(iii), references to scientific research related to a business or class of business includes:

- (a) any scientific research which may lead to or facilitate an extension of that business or, as the case may be, all businesses of that class; and
- (b) any scientific research of a medical nature which has a special relation to the welfare of workers employed in that business or, as the case may be, all business of that class.

SALE OF AN ASSET USED FOR SCIENTIFIC RESEARCH

(a) Sold without having been used for other purposes

Where the scientific research asset is sold off without having been used for other purposes, then the net sale price or the cost of the asset, which was earlier allowed as deduction under Section 35, whichever is less, shall be treated as business income of the previous year in which such asset is sold. Any excess of sale price over cost shall be subject to the provisions of the capital gains. This shall apply even if the business is not in existence in that previous year.

(b) Sold after having been used for purposes

Where the scientific research asset is used in the business after it ceases to be used as scientific research, the actual cost of such asset to be included in the relevant block of asset shall be taken as nil as the full amount has been allowed as deduction under Section 35. If this asset is later on sold, the money payable shall be deductible from the block in which such asset was earlier included.

CARRY FORWARD AND SET-OFF OF DEFICIENCY IN SUBSEQUENT YEARS

If on account of inadequacy or absence of profits of the business, deduction on account of capital expenditure referred to Section 35(1)(iv) cannot be allowed, fully or partly, the deficiency so arising is to be carried forward for unlimited years and set-off in any subsequent assessment year. However, carry forward of deficiency is subject to the condition that business loss already brought forward, if any, will have precedence over such deficiency in the matter of set-off.

In *Garden Silk v. CIT* 189 ITR 512, 522 the Supreme Court held that the capital expenditure on scientific research which cannot be absorbed by the profits of the relevant accounting year can be carried forward without any time limit, like unabsorbed depreciation allowance.

CONTRIBUTIONS/DONATIONS TO OUTSIDERS

Contributions to outsiders may be for—

- (i) scientific research; or
 - (ii) research in social science or statistical research.
- (i) *Scientific research.*

Contribution made to outside agencies for scientific research, whether related to the business of the assessee or not, is allowed as a deduction at the rate of one and one fourth times of the amount so paid in the previous year in which the contribution is made. The deduction is allowable only if the contribution is made to any of the following agencies:

- (a) a scientific research association which has the object of undertaking scientific research. Such association should be approved by the Central Government and notified in the Official Gazette, for this purpose; or
 - (b) a university, college or other institutions approved by the Central Government. Such institutions must be notified in the Official Gazette.
- (ii) *Research in social science or statistical research.*

Contributions made by the assessee to a university, college or other institution approved for this purpose, by the Central Government and notified in the Official Gazette, shall also be allowed as deduction at the rate of one and one fourth times of the amount so paid whether such research is related to the business of the assessee or not.

For example, unabsorbed capital expenditure on scientific research shall be allowed to be carried in the hands of the amalgamated company in the same manner as would have been allowed to the amalgamating company in the same manner as allowed after it ceases to be used for scientific research whether after being used for business or otherwise. The provisions which were applicable to amalgamating company shall be applicable to the amalgamated company as well.

CONSEQUENCES IN THE CASE OF AMALGAMATION

In pursuance of an agreement of amalgamation, if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provisions of Section 35 shall apply to the amalgamated company as they shall have applied to the amalgamating company if the latter had not transferred the asset.

TAX PLANNING IN CASE OF SCIENTIFIC RESEARCH

- (1) Revenue expenses incurred within 3 years preceding the date of commencement of business on account of the following are allowable in the previous year in which the assessee commences its business:
 - (a) Payment of salary to employees engaged in scientific research;
 - (b) Purchase of material used in scientific research.
- (2) Any capital expenditure incurred by the assessee in conducting a scientific research relating to the business of the assessee shall be allowed as deduction, but expenditure on acquisition of land after 29.2.1984 shall not be eligible for such deduction.
- (3) If the asset used for scientific research is to be sold, after having being used for scientific research, it may in some cases be beneficial if it is first used for the purpose of the business and then sold, to reduce the burden of tax.
- (4) Unabsorbed capital expenditure on scientific research can be carried forward in a similar way as unabsorbed depreciation is being carried forward.
- (5) With effect from Assessment Year 2000-2001, donations to eligible institutions for scientific/social or statistical research shall be eligible for a weighted deduction of one and one fourth times of the sum so paid.

In the implementation of various schemes for the promotion of research and development, the Income-tax Act, *inter-alia*, provides that expenditure made on capital equipment and related research activities shall be allowed to be written off to the extent of 100% in the year in which the expenditure is incurred.

In order to promote research and development activities in the commercial research and development

companies, a tax exemption from income-tax under section 80-IB(8A) of the Income-tax Act, 1961, has been granted to approved companies, whose main objective is scientific and industrial research.

EXCISE DUTY EXEMPTION TO RECOGNIZED SCIENTIFIC AND INDUSTRIAL RESEARCH ORGANISATIONS

All Scientific and Industrial Research Organisations (SIROs) recognized by DSIR are eligible for Excise duty exemptions on purchase of scientific and technical instruments, apparatus, equipment (including computers); accessories and spare parts thereof and consumables; computer software's, CD-ROMs, recorded magnetic tapes, micro films, microfiches; and prototype for research and development activities and programmes.

CUSTOMS DUTY EXEMPTION OF RECOGNISED SCIENTIFIC AND INDUSTRIAL RESEARCH ORGANISATIONS (SIROS)

All Scientific and Industrial Research Organisations (SIRO) enternal by DSIR are eligible for customs duty exemption on the import of scientific equipment, instruments, spares, accessories as well as consumables for research and development activities and programmes. The procedure for issuing the essential certificates for obtaining the customs duty exemption has been enternal. A Committee has been set up for this purpose to examine the applications received. The Committee meets periodically to examine the requests.

REGISTRATION OF PUBLIC FUNDED RESEARCH INSTITUTIONS, UNIVERSITIES ETC.

Public funded research institutions, universities, IITs, IISc, Regional Engineering colleges (RECs), Non-commercial research organizations (other than a hospital) are eligible for availing customs duty exemption on import of equipment, spares and accessories and consumables for research purposes. The passbook scheme, which was hitherto operated by the Department of Science and Technology and the Ministry of Human Resources Development, is superseded by a simple registration with DSIR. The ceiling on the value of goods imported for Research & Development is also removed and the head of the Public Funded Research Institutions/ Organizations duly registered with DSIR have been empowered to certify the research & development goods for duty free import. The Public Funded Research Institutions, Universities, IITs, IISc, and RECs, registered with DSIR are also eligible for Central Excise duty waiver on purchase of indigenously manufactured items for scientific research purposes.

CONCLUSION

In the present day scenario when each country is competing with other for attracting investments, India needs to strive hard to become a preferred and favorable destination viewed with assured power availability, good governance and an attractive physical environment. There is a great demand to create a supportive environment with transparency and easy access to information, technology and financial resources in which scientific research and development activities could flourish. More emphasis is required to be made on graded incentives with a promotional bias in favour of research and development units by various ways like, increasing employment in such areas, protecting the interest of local manufacturers, foreign technology tie-ups with local industries etc. Technology upgradation and modernization of existing Research & Development Units are very crucial for the competitiveness of Indian industry. It is therefore imperative to link existing Research & Development Institutions with various facets of industry e.g. technical training, technology development etc.

Since the key to growth is investment whether it is public, private, domestic or foreign, it is desirable for India to devise policy environment for boosting and attracting foreign investments in Research & Development sectors as the future of corporates bank on their ability to have a competitive edge in the dynamic global economic environment.

We strongly need to re-think-

1. Are there any promotional and facilitative ways by which Research & Development organizations in our country engaged in the promotion of Scientific Research & Development activities boost the flow of investments in our country keeping in mind the socio-economic policies of the Government?
2. Whether further focus on the available infrastructure for Research & Development units in the Country is called for. If so, how can it be encouraged to gain strength for attracting investments by foreign corporates?
3. Does India possess adequate resources for setting up Research & Development units in India or it needs to undergo restructuring through technology up-gradation, modernization etc.?
4. Can foreign corporates investing in Research & Development units be given more tax incentives by reforming laws?

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MEETING THE GIANTS : DEVELOPING STRATEGIES FOR FACING GLOBAL COMPETITION

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INTRODUCTION

Globalisation is the term used to describe the increased pace of interconnectedness that has taken place over recent years. It came about as a result of two developments. Firstly, technological changes have enabled information and goods to travel much faster than before, making it easier to transport things and communicate with people. Secondly, the end of the cold war and the spread of a new political philosophy of liberalization have led to the removal of trade barriers. As a result of globalisation, foreign trade and investment have grown dramatically and the world's economies and societies have become more and more integrated.

Today, we are witnessing the implosion, where four great forces—corporations, capital, communication and the citizens—can freely criss-cross national boundaries. A single virtual world is being formed, comprising hubs of economic activity, interconnected by technology, and unrelated to the geographic limits of the nation states that they are part of. Thus, economic liberalization, global business opportunities, increasing competition, onslaught of technological innovations and emergence of global communication networks have all impacted businesses in a large way.

Globalisation has opened up an array of opportunities to corporate India. To emerge successful in its new tryst with destiny, there are no soft options available and the Indian corporate sector must necessarily turn to good governance in its pursuit of competitive excellence in a challenging international business environment.

INDIAN CORPORATE SECTOR

As we stand in 2004, 57 years after independence, India is witnessing a new phenomenon on the industrial front. This is the emergence of a confident, competitive Indian industry, which is now looking at global markets increasingly, and not merely at defending its position in the Indian market as fortress India.

In the short decade that India has grappled with the challenges posed, and capitalized on the opportunities offered by a liberalizing economic environment, there are already shining examples of corporations achieving business excellence concurrently with, or perhaps more appropriately, because of the excellent standards that they have set for themselves. Further, maturation of the market place is likely to recognise and reward such corporations in greater measure in the decades ahead.

The going global is rapidly becoming Indian Company's mantra of choice. Indian companies are now looking forward to drive costs lower, innovate speedily, and increase their International presence. Companies are discovering that a global presence can help insulate them from the vagaries of domestic market and is one of the best ways to spread the risks. Indian Corporate sector has witnessed several strategically important success stories in the recent past. Tata Motors acquisition of Daewoo Commercial Vehicle Company, Tata Steel acquisition of Singapore's NatSteel, Reliance's acquisition of Flag is the culmination of Indian Company's efforts to establish a presence outside India. In terms of cost competitiveness, India's Steel Industry ranks among the top in the world (it is ahead of the US). Nalco and Hindalco are among the lowest-cost producers of aluminium in the world. Ranbaxy's products are successfully fighting in markets abroad against local or multinational brands and many of its labels are market leaders in their segments. A whopping 70 % of Ranbaxy's revenues come from abroad.

Reliance Industries, Infosys Technologies and Wipro are among the eight Indian companies that have been included in the Forbes magazine's list of best big companies in 2004. Bharat Petroleum, ITC, Bharti Tele-Ventures, Oil and Natural Gas Corp, and State Bank of India are the other domestic companies in the "World's 400 best big companies. India's software exports are on track to grow by 30 per cent in the year to March 2005, despite attempts in the key US Market to discourage

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outsourcing and protect jobs. India's information technology (IT) sector and business process outsourcing (BPO) industries, which offer back office and call centre services, logged exports worth \$12.5 billion in the 2003-2004 fiscal year. Nearly 25 per cent of the exports that involved 800,000 workers come from the top three companies in the sector namely Tata Consultancy Services Ltd, Infosys Technologies Ltd and Wipro Ltd.

India is also rapidly emerging as a hotspot for outsourcing pharmaceutical products, engineering design, R&D, clinical research, textiles and even auto components besides in IT enabled services. The obvious thing going for India is cost and quality of services. However, studies on outsourcing IT enabled services have shown that companies also stand to gain from reduced investments in physical and telecommunication infrastructure when they offshore work to Indian companies. India is ranked 34 in IMD's World Competitiveness Report, 2004. That is 16 ranks higher than its 2003 rank of 50. There's more in terms of business efficiency, its rank has moved from 51 to 22 and in terms of economic performance from 22 to 12. The ranking is not a surprise: the dismantling of the industrial licensing system, the rationalisation of the tax regime, and the removal of the competition-stiffing tariffs have not just contributed to faster economic growth they have made Indian companies more competitive.

Global tech research firm Forrester has recently in its report titled 'Low-Cost Global Delivery Model (GDM) Showdown' passed the verdict that Indian IT services vendors have better global delivery capabilities than their overseas counterparts. The report places Indian Vendors TCS, Wipro and Infosys a few decisive notches above IBM, EDS and Accenture on offshore capabilities.

IMPEDIMENTS IN PURSUIT

Despite the stunning success of Indian companies in the recent past, the fact that the number of true Indian multinationals can be counted on fingers remains an issue. Indian products and services are expected to be low-cost, low-price and low-margin. As a result the Indian companies are unable to invest in new resources and competencies that are necessary to protect and enhance their competitiveness in future.

Most Indian companies start on their internationalisation journey on the strength of their low-cost labour based manufacturing. They lack both the upstream capabilities of technology development and design and the downstream strengths in brand marketing and distribution. This is one area where Indian companies appear to face some difficulties. Perhaps, there is something in the psyche of the Indian management that

hinders their ability to work horizontally in a partnership mode with foreign firms. The ability to form, sustain and learn from alliances is a core competency that Indian companies will have to acquire or develop.

HOW ORGANISATIONS GO GLOBAL ?

An organisation typically proceeds through three stages. In stage I, management makes its first push toward going international merely by exporting its products to other countries. This is a passive step toward international involvement with minimal risk because management makes no serious efforts to tap foreign markets. Rather, the organisation fills foreign orders only when-or if-it gets them.

In stage II, management makes an overt commitment to sell its products in foreign countries or to have them made in foreign factories. However, there is still no physical presence of company personnel outside the company's home country. On the sales side, stage II typically is done either by sending domestic employees on regular business trips to meet foreign customers or by hiring foreign agents or brokers to represent the organisation's product line. On the manufacturing side, management contracts with a foreign firm to produce its products.

Stage III represents a strong commitment by management to explore international markets aggressively. Management can license or franchise to another firm the right to use its brand name, technology, or product specifications. This is a widely used approach among pharmaceutical companies and fast-food chains like Pizza Hut. Joint ventures involve a larger commitment since a domestic and a foreign firm shares the cost of developing new products or building production facilities in a foreign country. These are also often called strategic alliances. These partnerships provide a fast and less expensive way for companies to compete globally.

An organisation with a vision to become truly world-class and in turn competitive should consider and incorporate the following factors in its strategy:

- Premium quality of products/services
- Long-term vision
- Financial strength
- Market leadership
- Customer Centricism
- Strategic Leadership
- Organizational Culture and Climate

To quote a few instances, ICICI, on its aggressive path of internationalization is following the customer. It has already started on building its operations in Singapore, Dubai, Shanghai, New York, Canada and Britain. ICICI Bank has chosen this mix of subsidiaries, offshore branches and representative offices. Its senior managers will focus on India-related business, rather than trying to compete against global banks for global clients.

Infosys is developing downstream capabilities by creating proximity development centers (PDCs) in key cities around the world. It has recognized that it can not succeed globally unless it can develop insider positions with location wise domain knowledge within the business networks in the home countries of customers. Infosys's PDCs would be staffed predominantly by local people in an attempt to provide a local image.

OVERCOMING PAROCHIALISM

As a result of globalisation, foreign trade and investment have grown dramatically and the world's economies and societies have become more and more integrated. Doing business beyond the national borders is now a commonplace. Reliance Infocom is offering telecommunication services in US, Maruti is exporting its cars to middle east, Indian IT companies are making software for companies around the world. Not only are market borders blurring, but acquisitions, mergers and alliances are obscuring the nationality of many companies. To quote a few examples, half of Xerox's employees work on foreign soil, and half of Sony's employees are not Japanese.

As markets expand, national boundaries and national allegiance matter less and less. When the German manufacturer Daimler-Benz, makers of Mercedes luxury cars, merged with US carmaker Chrysler, one executive commented: "There are no German and American Companies. There are only successful and unsuccessful Companies."

Equally significant in creating a global village are incredible advancements in communication technologies. The Internet now permits instantaneous oral and written communication across time zones and continents. Software firms in Silicon Valley depend on programmers in India to solve intricate computer problems and return the solutions overnight *via* digital transmission.

As world commerce mingles more and more, another trend gives cross-cultural communication increasing importance. It is not unusual for German and Italians to speak three or four languages. Most Japanese school children begin studying English in the early elementary grades.

Successful global management requires enhanced sensitivity to differences in national customs and practices. Management practices that work in Asia may not work in Europe or America. As we enter this current period of globalisation and multiculturalism, managers are expected to make adjustments and adopt new attitudes. Adjustment and accommodation become easier if managers understand other cultures and respect them.

PEEPING INTO FUTURE

In the 70's work was normally outsourced to the domestic vendors in the local market, in 90's work started to be off shored to a low cost providing country. In the times to come global product/service will be produced with collaboration from various centres all over the world. The call centre may be based in Gurgaon, the back-end software developed in Manila while manufacturing takes place in Shanghai. According to a new report by the research firm Forrester Research, companies are trying to shift to a model that capitalises on centres of technological excellence around the world. New areas like web services, database monitoring, radio frequency identification, GPRS solutions, insurance and banking can now adopt this model.

The recent trend of globalisation suggests that the organisational structure that would stem from enabling features resulting from the convergence of several technologies and increasing demand for a global workforce would be rather virtual. Virtual organisations look like a great idea. However, organisations may not go for full scale virtual structure. Rather they may use virtual teams for tactical projects. After all, they allow an organisation to bring together its best minds to work on a project, regardless of where they are located.

With globalisation running rampant, virtual teams can cross the boundaries of company, culture and country and can be managed from anywhere. A growing body of industry research shows few organisations proactively adopt virtual teams as a means of creating a competitive advantage. Most organisations do so reactively, as a means of coping with an organisational structure that has grown through acquisition or rapid global expansion. At the same time the dangers of getting it wrong are also real. For the employees, working in a badly managed virtual team can leave team members feeling ambiguous about their role, reducing their level of commitment. This can lead to workers delivering sub-par performances and, eventually, to absenteeism.

Two issues stand in the way of managers successfully operating virtual teams. The first is the level of politics resident within the organisation and management fearing

they need to be close to people lest they suffer if they are not. The second issue is the maturity of managers themselves, and their ability to manage by objective rather than by headcount. Cultural trends can exacerbate the latter issue. While objective-based management is growing in popularity in Western Europe and North America, in Latin American countries, having their people gathered around them enhances a manager's importance.

The next step to empowering a virtual team is for management to make a top down assessment of the various tools available to that team. It can then decide when and how they can be best applied. These include traditional tools such as the telephone and e-mail, and also latest technologies like audio and video conferencing, online discussion forums, and collaborative file sharing. While none of these tools are especially new and, in many cases, are resident within the applications available to most workers in knowledge-related industries, rarely are those workers ever trained in their effective use.

ROLE OF PROFESSIONALS

A Professional is supposed to make judgements in situations where even knowing all the facts does not make it clear what would be the right course of action. Recognition of the difference between a profession and other forms of occupation is credited to the Greek doctor, Hippocrates, who lived 2500 year ago but the current range of different professions did not begin to emerge until the nineteenth century. Professionals normally have a code of ethics, take the trouble to keep their knowledge and expertise up-to-date and are paid to enable them to devote their time to using and improving their skills.

Technology is changing the world at a frightening speed. Professionals should therefore develop new skills that are not only based on sound and proven theories and concepts, but also laced with practical and contemporary issues and dimensions. They need to be leaders. They should possess and demonstrate qualities and characteristics that they would advocate as signals of success. From effective time-management, self-awareness, self-organisation and self-confidence to updating knowledge, net-working and effective communication skills, all these should not only be mere percepts and concepts, but possessed, practiced and demonstrated by a professional in his every day life.

In today's demanding business environment, organisations face multiple challenges. They have to

comply with law and regulation, communicate with their stakeholders, ensure that their internal procedures run smoothly and, of course, go about their everyday business. Organisations need people who can deliver on every front, ensuring that they find ways to meet their obligations, maintain efficient operations and prosper in their field.

Company Secretaries are ideally qualified to meet an organisation's multiple needs. The depth and breadth of their training ensures that Company Secretaries are equipped to answer multiple needs and to provide solutions to workplace issues. Their knowledge and expertise in company law, finance, contracts, general management and corporate governance can be applied to all sectors, from companies to local government, from charities to the armed forces, from universities to hospitals. With the strong requirement to meet and maintain the highest standards of probity and ethical behaviour, the Company Secretary is a true professional.

CONCLUSION

India is now set firmly on a faster growth path. It needs to follow a bold pro-growth programme of economic reforms. The goal should be to achieve a sustainable rate of growth of 7 to 9 per cent, which is necessary to make a quick and visible reduction in poverty, unemployment and regional imbalances.

In this endeavour to achieve self-growth and global growth, Indian Corporates will have to work actively with the International business community. If Indian companies are already a good business value proposition they can become even better one in the times to come.

A steady and growing market size, abundant availability of natural resources for manufacturing, cost attractiveness, reliable business community, high levels of intellectual manpower, engineering expertise and a reform process that has brought about impressive economic liberalization, would surely make Indian companies competent to meet the global giants.

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BUILDING STRATEGIES FOR SMEs TO GO GLOBAL : A PROFESSIONAL'S APPROACH

SAURABH KARWAYUN*

INTRODUCTION

Globalisation has created tremendous opportunities for trade and services in India. With India joining the World Trade Organisation, the competitive landscape is going to change significantly for incumbent Indian firms. With products from global competitors flooding the Indian market that are either superior in functionality or lower in price or both, innovation is the only way for survival, competitiveness and sustainable growth. Indian companies should have a comprehensive strategy in place to address global competition that is knocking their doors. The strategy should synthesize innovation within their companies that leverages their understanding of the Indian customers and encourages continuous process improvement to achieve a sustainable competitive advantage.

In this era of liberalisation, privatisation and globalisation, powerful forces are renovating markets and vividly changing the ways of doing business. Increased movement of people, goods and capital across borders has resulted in the emergence of global market segments and the growth of globally integrated markets. These trends facilitate managing of operations on a global scale and accelerate the need to deal effectively with global competition.

GLOBALISATION AND SMEs IN INDIA

In most developing countries, small and medium enterprises (SMEs) constitute the bulk of the industrial base and contribute significantly to their exports as well as to their GDP or GNP. For instance, India has nearly three million SMEs, which account for almost 50 per cent of industrial output and 42 per cent of India's total exports. It is the most important employment-generating sector and is an effective tool for promotion of balanced regional development. These account for 50% of private sector employment and 30–40% of value-addition in

manufacturing. It produces a diverse range of products (about 8000), including consumer items, capital and intermediate goods.

However, SMEs in India, which constitute more than 80% of the total number of industrial enterprises and form the backbone of industrial development, are as yet, in technological backwaters *vis-à-vis* advances in science and technology. They suffer from problems of sub-optimal scales of operations and technological obsolescence. While most of the large companies, even in developing countries, have financial as well as technical capacity to identify technological sources and evaluate alternate technologies that would suit their requirements, unfortunately, this competence is noticeably missing in most SMEs in India. As a result, small and medium enterprises (SMEs) need to adapt and rethink strategies to respond to these global forces by charting direction for future growth, realigning operations in the light of emerging market and competitor dynamics.

Small and Medium Enterprises (SMEs) have to go through a profound transmutation from inside out to have a long-term growth and sustainability. They have to change their metaphors of success of "winner takes all" and "success at all costs" and develop an inner value system that prides on ethics, innovation, equity, legitimacy, transparency and the courage to own failures. They should aim for technological upgradation through technological cooperation with foreign and local enterprises, with R&D institutions and centres of technology development.

Small in India is more than beautiful – it is efficient, adaptable and adds value in economic and social spheres. As the country integrates into the global village, the small and medium enterprises deserve special attention as they play a pivotal role in a country's socio-economic development. The problems faced by the SMEs,

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particularly in accessing technology and maintaining competitiveness has been formidable. The reasons for the inability of SMEs to identify their technology needs are:

- Poor financial situations and low levels of R&D;
- Poor adaptability to changing trade trends;
- Desire to avoid risk;
- Non-availability of technically trained human resources;
- Emphasis on production and not on production costs;
- Lack of management skills;
- Lack of access to technological information and consultancy services;
- Isolation from technology hubs.

However, in the present global, competitive and informative environment, Indian SMEs are realizing the need for dynamism, flexibility and innovative drive and are increasingly focusing on improved production methods, penetrative marketing strategies and modern scientific management capabilities to sustain and strengthen their operations. They are poised for global partnership and have the potential to absorb latest technical know-how in diverse industrial fields.

It is imperative for SMEs to enhance their access to the new technologies for increasing their competitiveness in the changing environment. It includes:

- (1) Formulation of appropriate national policies and programmes;
- (2) Building up technological capacity and strategies
- (3) Knowledge flows and technology databases;
- (4) R&D and inter firm linkages.

Indian economy has integrated itself to global market and the world's largest corporations are now entering India, which can make Indian giants look like pygmies, what to talk of small and medium enterprises! Tariff barriers are being lowered. In each area, a strong grasp of consumer needs, and continuous innovation in building trademarks, product and process design, technology and research & development will determine success.

Apart from the benefits of size, the large corporations entering the Indian market are able to take a long-term investment views, because they can serve their shareholders from their established bases in other

markets. In order to generate new ideas in a systematic way, companies have to look at multiple sources. Indian business houses can hope to succeed in this unequal battle, only if they learn to leverage their intimate knowledge of local consumers, by creatively segmenting the market, differentiating their brands and developing global strategies to meet the giants. Some of the strategies, which the SMEs should formulate, are discussed as under.

MARKETING STRATEGIES

Marketing encompasses the activities of identification of target groups, listening to customer needs, assessing the competitive landscape and then designing and creating products and services accompanied by messages that shape audience perceptions, leading to opportunities for revenue. The primary objective of marketing is to deliver products and services to the right audience at the right price and right time, thereby increasing brand loyalty.

The dramatic changes in the global marketing environment that are opening up new opportunities as well as ways of operating in these markets have long term implications on the marketing strategy of an enterprise. In particular, they imply the need to adopt a radically new perspective to strategy development in a rapidly globalising, highly competitive and technologically sophisticated environment.

Development and assessment of marketing strategy needs to be predicated on a broader view of the components that underline marketing strategy. International marketing strategy must encompass not only the outward manifestations of the marketing mix, but more broadly the factors within the enterprise and its environment that shape marketing strategy. Marketing strategy does not exist in isolation but is highly interdependent with strategies relative to outsourcing of raw materials and components, as well as licensing technology and acquiring other skills. Marketing strategy is also conditioned by the complexity of establishing and coordinating production, distributing products and linking point-of-scale to production across multiple countries. In developing its marketing strategy, the firm must consider how far key aspects are both contingent upon and integrated with other functions or activities of the firm.

For entering international markets, Indian SMEs have to consider not only the countries that offer the most attractive opportunities for its products and services but also the costs and likely risks of operating in that market. This requires a detailed examination of macro-economic

factors such as political and economic stability, capital market, foreign exchange risk, labour, management, cultural attributes cost of acquiring resources and the nature of the marketing infrastructure.

Marketing strategies also have to be co-coordinated or integrated with outsourcing strategies as well as production, management and logistical systems. Increased efficiency of transportation and communication networks coupled with greater awareness and sensitivity to cost and efficiency differences between countries and regions have generated pressures for the growth of global outsourcing. This in turn generates forces to co-ordinate operations at subsequent levels of the value chain across countries and regions. In the case of production and logistics, numerous synergies may be achieved through the integration and co-ordination of operations globally. Thus, marketing strategies play a key role in unleashing potential for increased efficiencies and integration of upstream activities across markets.

GLOBAL BRANDING POLICY

Branding has a long history, both in India and abroad. The word "Brand" is derived from the word "brandr", a word used by early Norse tribesman meaning 'to burn', as in branding livestock to declare ownership. Branding is effectively what the product of a particular company promises and advertises itself to be. It is the process of transforming a commodity into a unique customer experience.

THE CONCEPT OF BRAND

A brand is a mixture of attributes, tangible and intangible, symbolized in a trademark, which, if managed properly, creates value and influence. "Value" has different interpretations: from a marketing or consumer perspective it is "the promise and delivery of an experience"; from a business perspective it is "the security of future earnings"; from a legal perspective it is "a separable piece of intellectual property." Brands offer customers a means to choose and enable recognition within cluttered markets.

The enterprise's branding policy in international markets is another key issue in crafting a strategy for global markets. SMEs expanding in international markets have to consider whether to develop a branding strategy explicitly in relation to international markets and if so, what type of international brand architecture most appropriately give the firm's organizational structure and administrative heritage. Management has to decide whether to place emphasis on corporate, house or product level brands or some combination of these. The

balance between local, regional and global brands has to be determined as well as who should have custody for an international brand. The individual or organization with responsibility for managing an international brand has to ensure that the positioning of products sold under the brand name is consistent across different national or regional markets as well as product lines. Consistency of positioning is critical to maintaining a strong, coherent image and to avoid dilution of the brand name. The brand custodian should also be responsible for sanctioning brand extensions to other products and lines to ensure consistency in its use and sustain brand equity.

Whether or not the firm has an explicit international brand strategy depends to a substantial degree on how a firm has expanded internationally and how its international operations are organized. Some firms, such as Coca-Cola, Phillips and Nike have expanded through leveraging successful domestic "power" brands internationally. Consequently in expanding further, they have to consider whether to develop local or regional brands geared to specific regional or national preferences. For example, Coca-Cola uses the Coca-Cola name on its colas worldwide, including variants such as Cherry Coke, Coke-Lite or Diet Coke. In addition, Coca-Cola has a number of less known local brands such as Lilt, grapefruit and pineapple, and mango and orange in the U.K., and Cappy, a fruit drink sold in Eastern Europe and Turkey.

Other firms such as Nestle or Unilever have historically adopted country-centered strategies, building or acquiring large portfolios of national brands. In some cases successful products are marketed in other countries under different brand names or local brands and products are acquired resulting in a diverse assortment of brands and products spread across different countries. Such companies have to decide how far to move towards greater harmonization of brands and integration of their brand portfolios across countries, and if so, how to do it.

Escalating media costs, and increased communication and movement across national boundaries generate pressures for co-ordination of branding strategies across markets. In some instances, use of a corporate brand name or logo helps to provide a unifying image, enhancing position with the customer, and providing greater leverage with the retailer. Nestle, for example, has established an international branding tree consisting of four levels: Worldwide corporate brands, such as Nestle, strategic brands such as Kit-Kat, Polo, and After Eight; regional brands such as Mackintosh, and over 7,500 local brands available only in a single

country. The strategic, regional and local brands are always endorsed by a corporate level brand; the coffee and confectionery products by the Nestle brand; milk-based products by the Carnation brand, etc. to reinforce their global identity. In addition to determining the structure of the international brand portfolio and the degree of integration across countries, the firm has also to resolve custody issues. Procedure, tools and mechanism to manage custody have to establish, as well as guide to determine when and how brand extensions are permitted so as to avoid dilution of brand image. In many respects, the issues of global branding and how the firm deals with it is becoming a lynchpin of international marketing strategy.

The Indian Clusters

In India, at present, there are about 138 major clusters that are engaged in specialised industrial sub-sectors. To quote a few examples - locks at Aligarh, leather footwear at Agra and Kanpur; cotton hosiery at Ludhiana, Calcutta and Delhi; blankets in Panipat; power looms at Bhiwadi; diesel engines in Rajkot, diamond polishing in Surat.

Space bound "dense clusters" related to a specialized industry are even more pronounced in the State of Punjab with woolen garments, bicycle and bicycle parts, sewing machine parts and machine tools in Ludhiana; printing and printing goods, water pipes and bathroom fixtures in Jalandhar; foundries in Batala, etc.

Of these, the one at Ludhiana is one of the very successful clusters, having a wide range of diverse products building on "mechanical" skills, which include sewing machines parts, bicycle and bicycle parts, auto parts components and machine tools. Ludhiana is also better known as the Manchester of India, which alone contributes to the production of 95% of the country's woolen knitwear, 85% of country's knitting machines and 60% of the nation's bicycles and bicycle's parts.

Agra cluster makes 0.15 million pairs of shoes per day with a production value of 1.3 m US\$ and exporting shoes worth US \$ 57.14 million per annum. Knitwear cluster in Tiruppur, Tamil Nadu is responsible for 85% of Indian Market and its export earnings have expanded from US\$ 25 million in 1986 to US\$ 636 million in 1997. What is interesting about Tiruppur cluster is that it is organized in a web of small work places through which the entire town works like a living industrial organization.

ROLE OF PROFESSIONALS IN DEVELOPING SMEs

Traditional business strategies no longer suffice in a global business environment in which capital and technology move freely around the globe. One can no longer compete on the basis of traditional specialities like the cost of labour. Rather, innovation and productivity take the centre-stage.

In order to compete in the global market, small and medium enterprises with less in-house expertise, fewer resources and less formal management structures than larger corporations need to develop a business model which offers a good business value proposition. Fortunately, SMEs can find much of the expertise they require through Industry Associations, Chambers of Commerce, Management Consultants and Company Secretaries.

Company Secretaries by virtue of their academic exposure and training meet SMEs multiple needs and provide solutions to workplace issues. Their wide knowledge and practical exposure can be best applied to all SMEs. With the strong requirement to meet and maintain the highest standards of probity and ethical behaviour, the Company Secretaries are well equipped to meet this challenge. The road to implement a development philosophy in this competitive world will be different for SMEs, but with ingenuity, perseverance, cooperation and the expertise knowledge of professionals like Company Secretaries they can achieve the desired result.

SUMMING UP

In order to compete successfully, Indian SMEs need to meet the challenges of a rapidly globalizing, highly competitive and technologically complex environment. These challenges become yet more daunting with the accelerating pace of change and increasingly volatile and turbulent nature of global markets.

The complexity of the global market environment requires small and medium enterprises to look beyond marketing activities to examine more broadly the context in which these activities take place. Therefore, it can be concluded that even though large MNCs, international organizations and some government of developed countries are the main promoters of the process of globalisation, the circumstances are also suitable for innovative small firms that want to go global.

As since the SMEs cannot compete in mass scale market with large firms, therefore the best strategy is to look for specific market that demands specialised or

customized well designed products. When a small firm goes niche, it may gain a competitive advantage over other firms. The dynamic changes that are reshaping the international environment present opportunities for those able to adapt, but spell disaster for those that continue to do business as usual. SMEs that are only now beginning to deal with these issues will find themselves lagging behind those firms that have already embraced the new realities. Thus, the rapid pace of globalisation and fast growth of Asian economies present tremendous opportunities and challenges for Indian small and medium enterprises.

At present, India is standing at an important crossroad. This is a decisive moment. India has all the ingredients to become an economic super power. To achieve this vision India has to introduce immediate reforms to meet the global challenges, along with second-generation economic reforms.

SMEs are the backbone of Industrial development and can play a major role in the growth and development of an economy. A shining example of this is the Japanese SMEs, which are already playing an active role in the growth and development of Japanese economy. Japan has approximately 4.69 million SMEs (99.7 percent of all companies), which employ around 29.96 million people (70.2 percent of all company employees). A highly diverse range of SMEs support the Japanese economy, ranging from companies with world-class technology through to retail stores rooted in the local community. If India wants to become an economic superpower Indian SMEs will also have to play a major role. They can surely adopt the Japanese model of developing SMEs to meet the global giants.

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ICSI VISION PLAN 2010*

1. INTRODUCTION

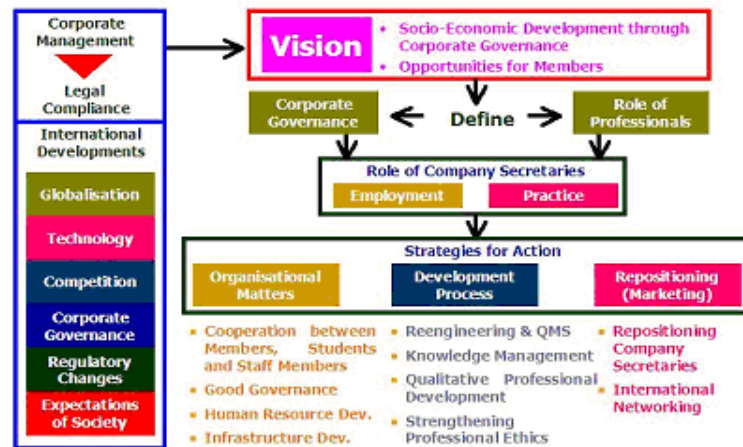
Over the last three decades, our profession has made tremendous strides and undoubtedly an impressive mark in the corporate arena and comity of professionals. It indeed is a matter of proud for all of us, but it is not a time to be complacent. The changing paradigm propelled by information technology has shaken the foundation of traditional thinking and created new structures, approaches and expectations.

Globalisation of trade in goods and services, increasing competition, sharp focus on corporate

governance, changing regulatory regime and private-public partnership have bearing on each constituent of the economy, be it individual, organisation, the community of professionals or the nation. These factors have bearing on the profession and also bringing opportunities and also threats for company secretaries.

In February 2003, the Council of ICSI adopted new Vision and Mission Statements for the Institute considering SWOT analysis, extensive research on international developments, perspective planning group report and suggestions from members and students.

ICSI Vision Plan 2010 Development Process



ICSI Vision Plan 2010 provides insight into the future and lists out long-term strategies to be implemented for capitalising on opportunities and taking positively on challenges in long run. Long-term strategy would focus on fully utilising the skills, knowledge and core competency in the most rapid, efficient and organised manner.

Based on the above premises, this vision plan has been prepared to project and develop Company

Secretaries as experts in Corporate Governance and take role of Principal Officer of the Company.

2. PROFESSION OF COMPANY SECRETARIES

2.1 Meaning of 'Secretary'

The word "secretary" originates from the Latin word 'secretarius' and concept of keeping secrets reflecting the confidentiality of role and trust placed on its holder. In any company, matters of strategic

* Compiled by Bhuvnesh Chaturvedi, Consultant, the ICSI.

importance are kept secret due to their significance in a competitive business environment. Hence, a person having overall knowledge of business, the highest level of integrity and independence is required to man the position.

Activities of all departments of a company must be directed towards a common objective of all stakeholders i.e. company's vision. Board of Directors being trustees of shareholders are entrusted with the task of taking strategic decisions in the best interest of the company. These strategic decisions are based on information from all departments and external agencies. This information may include company performance, competitive intelligence, new investment proposal, confidential reports, company disputes, etc. As information supplied to Board of Directors is confidential in nature, a person of high integrity and independence is entrusted with the task of collection, compilation, analysis and presentation of the information as per the needs of the Board of Directors.

Therefore, the need for a professional with desired level of integrity and competence was felt and thus a Company Secretary came into existence to coordinate various functions of the company, place

desired information before the board, provide inputs to the Board to enable it to take policy decisions, advise the Board in its responsibilities and attend the meetings of the Board and its committees and initiate follow up action. Duties and responsibilities of a Company Secretary go far beyond and require him to be the repository of knowledge, competent manager and advisor to management in achieving the corporate vision.

Being a vital link between the all stakeholders he is often called upon to interact, communicate and resolve conflicting interest of various stakeholders and create an atmosphere of mutual trust. In fact, every progressing company needs a person for coordinating affairs of various management functions towards the company's vision.

Over the years, the professional expertise, knowledge strength and core competency of Company Secretaries, both in employment and in practice, is not only well recognized by the Government, regulatory authorities and corporate sector, but more and more trust and confidence is being reposed in the profession of Company Secretaries.



BACKGROUND

2.2 Company Secretaries Act, 1980

The Company Secretaries Act, 1980 was enacted when business was mostly family owned and the promoters did not have much expertise and knowledge of managing the business. Company Secretary was considered an appropriate person to bring professionalism in corporate management and make contribution to industrial growth that was critical for self-sufficiency, economic self-reliance and employment generation.

While moving the Company Secretaries Bill, 1980 for consideration by the Lok Sabha on 16th June, 1980, the then Minister of Law, Justice and Company Affairs, Shri P Shiv Shankar had said, "An essential ingredient in the healthy growth of the corporate sector is the induction of professional management. The Government attaches special importance to the development of professional management, so that the corporate sector can evolve and function in tune with the changing needs of the times, and the social responsibilities that this important segment of the economy has to shoulder. The profession of Company Secretaries has an important part to play in the introduction of professionalism in the area of corporate management".

The Institute of Company Secretaries of India has since been converted into a statutory body w.e.f. 1.1.1981 under the Company Secretaries Act, 1980 (56 of 1980) to regulate and develop the profession of Company Secretaries. Relevant provisions of Company Secretaries Act, 1980 specifies the role of Company Secretaries are as under:

Sub-Section (2) of Section 2

(b) *Perform or performs services in relation to promotion, forming, incorporation, amalgamation, reconstruction, reorganisation or winding up of the Companies.*

These are areas of Strategic Management and require expertise knowledge, skills extensive research, innovation, analysis, negotiation and documentation.

(c) (i) *An Authorised Representative of a company – with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications and returns) by or on behalf of the company*

Authorised representative does not mean only representation before government and regulatory authorities. Representation

is also made to Investors, business partners, banks and lenders, arbitrators, customers, suppliers, etc.

(c)(v) *Secretarial Auditor or Consultant.*

Secretarial Audit is an audit of compliance of all laws and corporate governance norms.

(c)(vi) *Advisor to company on management, including legal or procedural matters falling under or any law for the time being in force.*

Management functions include Strategy, Legal, Financial, HRD, Marketing, Production, Information Technology, Infrastructure, R&D, Quality, etc. Laws that are applicable to companies can be classified under Company Law, Securities Related Laws, Consumer Related Laws, Labour and Industrial Laws, Environment Protection Laws, Tax Laws, IPR Laws, Industry Specific Laws and General Business Laws.

Hence, in 1980, a Company Secretary was perceived to perform its functions not only during the life of a company but beyond as it's authorized representative, and an advisor on management and legal aspects.

Today a Company Secretary is appointed not only to perform the duties as prescribed for a Secretary under the Companies Act but for several other functions as well. A Company Secretary is also included in the definition of officers in default under section 5 of the Companies Act and is punishable in the same way as the directors of the company. Similarly, under section 303 of the Act the particulars of a Company Secretary are required to be kept in the Register of Directors even though his remuneration is not considered for the purpose of calculating overall managerial remuneration. Also as in the case of director, his particulars are required to be filed with the Registrar of Companies. A Company Secretary is also required to sign the Balance Sheet and Profit & Loss Account alongwith the Directors of the company.

2.3 Need for Change

When the concept of Company Secretary was mooted in India, plethora of laws governing

companies, compliance of which took most of the precious time of the strategic management team, which led to slow down in decision-making process. Management at that time meant effective compliance of complex legal requirements. As Company Secretaries were appointed as legal requirement, the top management entrusted them with the job of compliance of laws. Thus compliance of law became the core competence of Company Secretaries.

In a changing scenario, of increasing globalisation, advancing technology, stiff competition, better awareness for good corporate governance, easy to comply and tough to non-comply laws, and increasing expectations of society, **Corporate Management on Ethical Standards is critical for Corporate Perpetuity.**

A Company Secretary due to his education, training, skill, position in a company and applicability of Code of Conduct, is the right person to ensure better corporate management on ethical standards.

Hence time has arrived that company secretaries should update their knowledge and skills best management practices so that they can contribute effectively in growth of the company and its stakeholders.

3. INTERNATIONAL DEVELOPMENTS

Certain international developments have bearing on each constituent of the economy, be it individual, organisation, the community of professionals or the nation. These changes are bringing opportunities and also threats for professionals. Accordingly strategies need to be developed and implemented in order to capitalise on opportunities and convert threats into profitable opportunities.

3.1 Globalisation of Trade in Goods and Services

People are moving more freely than ever for trade, commerce, employment, marriage, visiting relatives, holiday travels, medical treatment, etc. It is free and fair trade and vanishing economic boundaries under WTO regime. UN, WTO, WB, IMF, OECD, ADB and ICC are standardising rules for International Trade. Foreign Companies are coming to India and FDI Norms are being simplified. E-commerce standards (like UN EDIFACT) are international standards for data communication. Internet and ERP Vendors (SAP, Oracle, Baan, PeopleSoft, etc) are spreading International Best Practices in Business. Forex Reserves of over USD

100 Billion tell the story of increasing globalisation in quantitative terms.

Presence of Multinational Accounting Firms and consulting firms like McKinsey, Accenture, IBM, BCG, Dimension and other international consulting firms support the conviction that international opportunities exist even before the opening up of the Service Sector under the General Agreement in Trade in Services (WTO-GATS).

With increasing globalisation of trade in good and services, opportunities are opening up for professionals both in India and abroad. International opportunities include Corporate Governance, Advisory and Compliances in Multinational Regulatory Environment, Investment Advisory, Intellectual Property Rights, Commercial Arbitration and ADR, Management Consultancy Services, BPO and Related Services, International Taxation and Transfer Pricing and host of other services.

Globalisation also comes with certain challenges for Indian professionals:

- Competition from foreign professionals firms (already started)
- Client's expectation of quality of service at international standards
- Knowledge of regulatory environment and customs of trade and commerce in foreign countries
- Foreign Culture and Languages
- Operational infrastructure in foreign countries and networking between professionals

The growth of business depends mainly on leadership skills of professionals. Continual innovation backed by strong risk management system is going to be critical for growth in international market. Hence, professionals should think global and develop strategies accordingly. Time has come to expand our network across the globe as fast as possible.

3.2 Advancements in Technology (Information and Communication)

The knowledge and information revolution is not just a short-term blip on the radar screen which peaked in 2000 with the boom in Dot Com Companies. It is a real and profound opportunity for countries around the world to increase the pace and scope of the benefits of development. It marks

a significant shift in the relative importance of different resources or factors of production in the development process.

Apart from generating new employment opportunities, the application of IT has vastly extended to access to education, health care, markets, professional services, financial services, managerial and consultancy services and other aspects of modern society to many more people at far lower cost. It has dramatically reduced the cost of communications, improved access to technology and marketing capabilities, eliminated intermediary exploitation in the production and distribution chains, increased corporate accountability and stimulate shareholder participation in the affairs of the company.

Virtual Office (anywhere and anytime services) is a reality these days. ERP, EDI Systems and E-Commerce have integrated the whole supply chain and it is removing all intermediaries. Online Analytical Processing (OLAP) makes real-time analysis of large volumes of data where business decisions are taken by Artificial Intelligence (Expert Systems). Secretarial Software and Legal Websites make it so easy that one professional can handle any number of companies. In the era of information technology need for professionals providing traditional services may not arise.

Hence, professionals should focus on building capacity to handle complex business problems in long term where information technology has its limitations and develop their niche accordingly. However, information technology is a necessary tool for carrying out operations of the company efficiently. Company Secretaries should make best possible use of IT tools in their professional activities.

3.3 Competition in Professional Services

Competition from professionals needs no mention. Except the services that require exclusive qualification by law, most of the services provided by professionals are similar like Legal Advisory, Management Consulting, Due Diligence, IT and BPO, HR Consulting and Representation & Negotiations.

Competition from domain experts and competitive services from financial intermediaries poses a great threat. Most of the Educational and Research Institutions, Chambers of Commerce, etc. are undertaking sponsored research and consulting

assignments. Opinion of these organisations has better credibility than small consulting firms since these organisations have developed reputation over a long period of time.

All merchant bankers provide total financial solutions to their clients. Banks have started giving management support to their assisted companies. KVIC and NABARD have recently started Consulting Services. This is an indication that in future funding agencies will enter into Consulting by utilising their existing employees and infrastructure to their maximum advantage. Thus adding competition to professionals.

Competition is increasing faster than ever. Only those who innovate and act fast will be able to survive. Hence a strong Research and Development alongwith a Competitive Intelligence System that it responds faster to the environment changes is a necessity these days.

3.4 Changing Regulatory Framework (Growth Oriented)

With the initiation of economic reforms process in July 1991, the Government has initiated the process of Legislative Reforms to suit the changing policy orientation and to fulfil its obligations under WTO. Infact the major legislative reforms include corporate and economic legislations, company law, securities laws, labour and industrial laws, etc. In the case of company law, major amendments have been incorporated to make it a growth-oriented law providing conducive environment for corporates to develop and grow, simultaneously remaining good corporate citizen.

The thrust of the whole legislative reforms process is towards empowering corporates and business community to operate in a conducive environment without unnecessary procedural obstacles and Government intervention. But at the same Government expects the enterprises to keep their houses clean, transparent and accountable to all the stakeholders.

There are over 80 laws applicable to a company, compliance of which takes most of the time of the top management. This had adverse effect on leadership development and growth of the companies. However, the time is changing from over-regulation to self-governance. The industry is demanding more and more relaxations in compliance of stricter laws in order to grow at accelerated rate

and become competitive in international market.

Naresh Chandra Committee II Report says that the Companies Act, 1956 was rooted in an environment that spawned the license and permit raj in India. The need for revisiting the law governing private companies, with a view to providing a simple and cost-effective framework, cannot be over emphasised. According the Report to suggests a more scientific and rational regulatory environment, the hallmark of which is the quality, rather than the quantity, of regulation.

The Vision Statement DCA is “to usher in an era of good Corporate Governance, facilitate a comprehensive regulatory environment with simplified corporate laws but stringent penalties for violations, strengthen & accelerate the growth of the corporate sector to enable it to be globally competitive, safeguard the interests of small investors, and enhance confidence of investors, both domestic and foreign.”

The DCA is itself moving towards simplified corporate laws in order to strengthen & accelerate the growth of the corporate sector to enable it to be globally competitive. Hence we can expect further simplification of corporate laws.

Simplification of law and e-governance will affect volume of work relating to compliances, which is currently the main function of most of company secretaries. But there exist opportunities in complex legal issues like:

- *Certification* – Issuing certificates required under various laws
- *Audit* – Conducting Secretarial Audit, Securities Audit, Intermediaries Audit and other Audits as required under any law for the time being in force or voluntary initiatives of companies
- *Representation* – Authorised representative before government and regulatory bodies, quasi-judicial bodies, etc.
- *Advisory* – Advising on applicability, interpretation and procedures under various laws
- *Due Diligence, Search, Credit Reporting, etc.*
- *Legal Documentation* – Drafting and vetting of various legal documents including merger deals, agreements, contracts, deeds, power of attorney, etc.
- *Arbitration and Conciliation* – Arbitration,

conciliation and Other Alternate Dispute Resolution (ADR) methods for settlement of commercial disputes.

With increasing competition only large firms will take maximum share in opportunities in legal arena. Company Secretaries should focus mainly on these types of legal services in long run and form mega firms.

3.5 Sharp Focus on Corporate Governance

Another development in context of globalisation is sharp focus on corporate governance. The history of corporate governance has been punctuated by a series of well-known company failures most recently Enron, World Com, etc. Each crisis or major corporate failure – often a result of incompetence, fraud, and abuse – was met by new elements of an improved system of corporate governance.

Recently, the Naresh Chandra Committee on Corporate Audit and Governance made recommendations having far reaching implications for corporate governance norms. In India the Kumar Mangalam Birla Committee outlined a code of good Corporate Governance, which has been operationalised by inserting a new clause (Clause 49) to the Listing Agreement, and have been made applicable to all the listed companies in India in a phased manner. Recently the Narayana Murthy Committee has further refined the corporate governance norms which are proposed to be implemented through modification in the listing agreement.

The initiatives for improvement in corporate governance are coming mainly from three sources namely, Market, Regulator and Legislature. The most important initiative comes from market forces and mechanisms which encourage and insist on the management’s improving the quality of corporate governance.

Corporate Governance also makes a business sense. The first advantage is growth (growing revenues, growing profits, growing market value). Secondly companies get widespread goodwill and brand reputation, resulting into widening customer base, ready market for new products, access to global markets, and better access to human capital. Thirdly enhanced trust and confidence of all stakeholders – investors, employees, customers, suppliers, government and regulators, and society at large thus enhancing wealth creation capabilities and leading to sustainability of company.

If we look at companies that have won ICSI National Award for Excellence in Corporate Governance, we find that these companies have grown even in turbulent times. Their products and securities command premium in the market leading to better financial standing. Infosys (awarded by the ICSI in 2001) is amongst the best-governed companies in India and it has grown significantly even when many IT companies have vanished. BSES (2001) has consistently earned high returns, increased its net worth and enhanced its shareholders wealth for so many decades. Dr. Reddy Lab's (2002) strong research and development, combined technical excellence with professional management and best HR policies has brought it amongst highly respected companies in India. TISCO (2002) is one of the lowest cost steel producers in the world and is amongst the most profitable steel companies. Its corporate sustainability model and ethical dealings with customer, government and business partners makes this possible. IBP (2002) has maintained and updated its professional management culture, system and processes. The thrust of its human resource policies is to develop people into 'achievers' than just 'performers'. Reliance Industries Ltd. (2003) has largest investor base in the country and HDFC Ltd. (2003) is one of the most trusted companies in India. The Public Sector Undertaking ONGC Ltd. (2003) has the highest Net Worth in India and its Public Offer (Second largest in the world) has been oversubscribed more than 6 times.

Therefore, findings of the McKinsey and Co.'s Global Investor Opinion Survey are not surprising that an overwhelming majority of investors are prepared to pay a premium for companies exhibiting high governance standards.

The ICSI, after extensive research, has taken a lead step in defining Corporate Governance as *"the application of best management practices, compliance of law in letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders."*

Corporate governance is not restricted to board systems and audit committees. It is an approach to sustainable development. This philosophy finds applicability in both developed countries and also underdeveloped/developing economies like those in Asia-Pacific, Africa and Latin America. The

principles of corporate governance as contained in the definition itself are as under:

- *Sustainable development of all stakeholders* – Main object of any organisation is sustainable development of all stakeholders. An organisation must ensure growth of all individuals associated with or affected by the enterprise on sustainable basis.
- *Effective management and distribution of wealth* – Wealth creation, management and sharing are operational objectives towards main object. An organisation must ensure that enterprise creates maximum wealth and uses judiciously the wealth so created for providing maximum benefits to all stakeholders and enhancing its wealth creation capabilities to maintain sustainability.
- *Discharge of social responsibility* – Organisations have responsibility towards environment in which they operate i.e Nature and Society. An organisation must ensure that it is acceptable to the society in which it is functioning.
- *Application of best management practices* – An organisation must ensure excellence in functioning of enterprise and optimum creation of wealth on sustainable basis.
- *Compliance of law in letter and spirit* – Sharing of wealth requires compliance of law in letter and spirit. An organisation must ensure ensure minimum returns/ benefits to all stakeholders guaranteed by the law for maintaining socio-economic balance.
- *Adherence to ethical standards* – Adherence to ethical standards is critical for developing mutual trust between all stakeholders. An organisation must ensure integrity, transparency, independence and accountability in dealings with all stakeholders.

The research and principles evolved so far around the world find less applicability in underdeveloped/ developing countries due to their shareholder orientation and focus on to publicly traded companies whereas the market capitalization of listed companies is very low as compared developed countries. Still Agriculture, small-scale industrial units and unorganised sector are major providers of employment in underdeveloped/ developing countries.

It is well accepted that shareholders are key stakeholders and they expect management to use

their hard earned money responsibly to the productive use and give them due returns. But there are other stakeholders on whom the company depends heavily. They associate with the company to make it a successful venture. They also have certain expectations. Employees expect adequate remuneration for their services and security so that they can lead a better life. Customers expect best quality products at minimum price so that they can achieve various ends with their scarce means. Suppliers/Vendors expect fair and timely return on goods and services supplied by them. Lenders expect timely repayment of loan and interest thereon. Government expects management to be partner in nation building by paying accurate taxes or directly incurring expenditure on national development projects. The society has a larger stake and thus larger expectations. It owns the resources that move through value chain. Sustainability of business mainly depends on sustainability of these scarce resources. The management is expected to use the natural resources judiciously so as to maintain ecological balance and sustainable development.

Underdeveloped and developing countries are also marked by high unemployment and labour exploitation, low education rates (not literate), low liquidity in market, risk in commercial dealings - security of payments due to suppliers and lenders, low quality products to customers at high prices due to demand and supply mismatch, corruption and ineffective regulatory process, knowledge disadvantage – technology and management systems and competition due to opening of economies in east from capital intensive approach of west.

The ICSI's approach to Corporate Governance provides solution to critical development issues. Company Secretaries have a major role to play in ensuring good corporate governance. Company Secretaries ensure management of board affairs at highest level and compliance of law in letter and spirit. They are imparted wider knowledge of management functions, major laws applicable to a company as well as of good corporate governance practices and are controlled by Professional Code of Conduct under the Company Secretaries Act 1980, so as to ensure ethics in dealing with all stakeholders.

3.6 Developed India Vision 2020

Company Secretaries are playing a vital role in

Corporate Sector but now they need to ensure that corporate sector plays its role in realising the Developed India Vision 2020. Being responsible professional institution ICSI need to extend its hand in making India a developed country.

Speaking at the opening ceremony of World Summit for Sustained Development, South African president Thabo Mbeki said: "I am certain that we are of one mind that the imperative of human solidarity as well as actual experience, demand that we must strive for a shared prosperity. A global human society based on poverty for many and prosperity for a few, characterized by islands of wealth, surrounded by a sea of poverty, is unsustainable", he added. "All of us understand that the goal of shared prosperity is achievable because, for the first time in human history, human society possesses that capacity, the knowledge and the resources to eradicate poverty and underdevelopment. To use these possibilities successfully requires that we also agree to the concept of a common but differentiated responsibility", Mbeki said.

Appreciating the declaration of World Summit for Sustained Development, development should not be restricted to India alone and initiatives should be taken towards sustained development of the whole world.

Industry gives employment to illiterates, high school pass, graduates, masters and professionals like Company Secretaries. People talk about self-governance but its industry that implements self-governance principles. Growth of industry is crucial for growth of society. Growth of industry brings growth in employment (income), growth of wealth, growth of nations and growth of mankind.

Corporate Social Responsibility is the heart of Corporate Governance and being expert in Good Corporate Governance practices the Company Secretaries will be required to play a major role Societal Development. Also with increasing Public-Private Partnership in National development, the demand for company secretaries will increase in voluntary and non-corporate sector engaged in development planning, implementation and monitoring.

These developments will go a long way in redefining the role of company secretaries. Traditional thinking is no longer valid and Company Secretaries should innovate and collaborate in order to make maximum out of the increasing opportunities.

4. ROLE OF COMPANY SECRETARIES – VISION FOR FUTURE

Directors being trustees of shareholders are entrusted with the task of taking strategic decisions in the best interest of all the stakeholders. The information on which these strategic decisions are based on the information collected, compiled, analysed and presented by the Company Secretary. This information may include company performance, competitive intelligence, new investment proposal, confidential report, company disputes, etc. Decisions of the Board of Directors are communicated to various departments and the Company Secretary is generally entrusted with the task of follow-up and preparation of report on progress of the implementation of decisions.

A person having adequate knowledge of activities of various departments and external agencies can make more meaningful reports leading to better decision-making and corrective action. Therefore besides exhibiting excellence in areas of core competence of law, the Company Secretary will be required to contribute significantly in decision-making process of the company in era of increasing competition because of globalisation of trade in goods and services. A Company Secretary is, therefore, required to diversify his knowledge; learn laws of foreign countries; learn new management techniques; and use information technology to his advantage.

4.1 Role of Company Secretaries in Corporate Governance

In the era of Good Corporate Governance the role of Company Secretaries is getting widened due to his multidisciplinary knowledge of law and management. Since ethics has to play a key role in Corporate Governance, adherence to the Code of Conduct under Company Secretaries Act becomes his competitive advantage.

According to ICSI, Corporate Governance is the application of best management practices, compliance of law in letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.

The soul of Corporate Governance lies in three words Management, Law and Ethics. Company Secretary being the Principal Officer of the Company has the responsibility to ensure application of Best Management Practices, Compliance of Law

and embedding Ethics into culture of organisation.

Company Secretaries will be required to advise management on new management techniques so that the company maximises its wealth. Management practices may include Knowledge Management (KM), People Capability Maturity Model (P-CMM), Effective Risk/ Crisis Management, Supply Chain Management (SCM), Customer Relationship Management (CRM), Quality Management (ISO, CMM, Six Sigma, TQM), Environment Management System (EMS) and Enterprise Resource Planning (ERP), etc.

Compliance of company and securities laws has already been core competence of company secretaries however they need to diversify into other laws also like Competition and Consumer Related Laws, Labour and Industrial Laws, Environment Protection Laws, Tax Laws, IPR Laws, Industry Specific Laws and General Business Laws

Company Secretaries being bound by the Code of Conduct has to ensure that he and his company adhere to ethical standards and ensure fairness to all stakeholders, transparency and disclosure, raising trust and confidence of stakeholders and following every law of land even when the law enforcers may not be able to detect violation.

Compliance of various laws has been the core competence of Company Secretaries whereas he is required to have sufficient knowledge of management practices listed above to carry out his duties more effectively and efficiently. He is not expected to have specialisation in various management practices listed above since his position is of a Coordinator who has to ensure that best management practices are followed and law is complied in letter and spirit.

Hence, the knowledge of overall corporate governance helps him serve in best interest of the company, all stakeholders and the industry.

4.2 Focus of Services in Changing Paradigm

To meet the growing challenges of changing paradigm, there has to be a paradigm shift in the role of a Company Secretaries. They have to look beyond their traditional mould and become proactive to meet the expectations of the corporate sector in particular and the society at large. This will require a shift in fundamental thinking of Company Secretaries.

The changing paradigm indicates towards change in profile of services of the Company Secretaries both the content and manner of providing services. Since most of the compliances and consolidation of information will be handled through information technology, Company Secretaries must focus on matters of strategic importance and expand their expertise in core areas and explore newer areas. They will be expected to have knowledge of overall business operations including all management functions and possess leadership qualities to handle such a wider role.

Opportunities to serve corporate sector are unlimited. Company Secretaries need to learn new skills and diversify into new segments – different services, different knowledge areas, different corporate structures, different industries, different scales and different geographies of operations.

Company Secretaries need to provide PQRS – Productivity, Quality, Reliability and Service to Employers and Clients. They must advise management on how to use resources in most profitable manner and show that they are Profit Centres and not Cost Centres. Quality cannot be compromised and they must use due skill and care in performance of their duties. They must exhibit trust and loyalty to company all the time due their confidential nature of work. Company Secretaries have wider knowledge base and hence they are expected to add value to various activities of the Company.

Creativity, confidence and communication define the competitiveness of the Company Secretaries in professional market. Company Secretaries should use technology to beat technology. Extensive use of Internet, ERP, CRM, Data Mining Tools and discovering computer based business analysis models is essential for providing best services to clients.

4.3 Definition of Role of Company Secretaries for Brand Building

Currently, company secretaries are providing variety of services and their role varies significantly from segment to segment. In order to create a unified brand for Company Secretaries, there is need to define the role of Company Secretaries both in employment and practice. The following definitions try to crystallize the role of Company Secretaries:

Company Secretary in Employment

The Company Secretary, a professional bound by the Code of Conduct, aligns various management

functions with company policies, ensures compliance of all applicable laws and endeavours to develop mutual trust between various stakeholders leading to good corporate governance and sustainable growth of the company.

A Company Secretary is required to coordinate between various departments for all decision of the Board of Directors and also for providing information to various stakeholders. Since he has access to all kinds of information (confidential or public) of the company, he is required to ensure compliance of Companies Act, Listing Agreement and other applicable laws. Being a vital link between all the stakeholders, he has to ensure adherence to ethical standards in all dealings. All this leads to good corporate governance and sustainable growth of the company.

The Company Secretary is employment is expected to have thorough knowledge of provisions of the legislations under which the organisation is created. Knowledge of activities of all activities of the company will help him perform his task better.

Company Secretary in Practice

The Company Secretary in practice is an independent professional, bound by the Code of Conduct, rendering audit, advisory and representation services in relation to management, law and corporate governance processes and practices.

As discussed earlier, the Company Secretaries Act 1980 indicated three main kinds of services a Company Secretaries provide viz. Audit (Secretarial Audit, Securities Audit, Intermediaries Audit, Due Diligence and Certification), Advisory (Legal and Management) and Representation (Authorized Representative of the Company) before Tribunals and quasi judicial bodies).

The Company Secretary is practice must have specialisation in the services he is providing. A practising member will not be in position to undertake any assignment unless he has thorough understanding and experience in the subject matter.

Hence, appropriate strategies need to be developed to highlight the capabilities of Company Secretaries and qualitative development of members in the changing paradigm.

5. VISION AND MISSION STATEMENTS

Taking a proactive approach ICSI has adopted new Vision and Mission Statements. These statements have

been drafted considering developments in international business environment.

5.1 Vision Statement

“To be global leader in development of professionals specialising in corporate governance”

To be a global leader is to have global presence and set global benchmarks in our endeavour. We shall achieve global leadership in development of professionals ensuring best management practices, compliance of law in letter and spirit and adherence to ethical standards.

Our members shall act as catalyst in execution of the best practices in corporate governance in corporate world. Good corporate governance practices shall lead to growth of corporate world and ultimately the growth of all stakeholders including investors, suppliers, customers, employees and society.

We shall attain global leadership with the synergy of our members, students and human assets.

5.2 Mission Statement

“To continuously develop high calibre professionals ensuring good corporate governance and effective management and to carry out proactive research and development activities for protection of interest of all stakeholders, thus contributing to public good”

To realize the vision of global leadership, we shall make our members realize their potential, and build world-class competencies. Members shall be so developed that they can be engaged right from the concept to successful running of companies. We shall continuously sharpen skills in good corporate governance and effective management of the enterprises all across the globe.

To build world-class competencies, we shall carry out proactive research and professional development activities so that our members render best quality of services for the growth and expansion of corporate world and in turn the human society.

Appropriate strategies have been developed by the ICSI to realise the vision at the earliest.

6. STRATEGIC MANAGEMENT TEAM

1+1 can make 11 if they work as a team. Team spirit is to be complement and supplement to each other for achievement of team objectives. It is about synergy

of the best brains for giving best performance to make big dreams come true.

Our vision is a difficult task and visionary leadership in form of a multidisciplinary team to look beyond today is absolute necessity. The strategic team shall implement the strategies to capitalise on the future opportunities and take on the future challenges with ease.

Persons having specialised and multidisciplinary knowledge form such a team. Information technology expert needs to be involved since beginning so that full use of technology can be made. Following the key responsibilities of the Strategic Management Team:

- Communicating ICSI Vision Plan 2010 to employees and members and securing their cooperation in implementation process,
- Formulating Operational Plan to implement the strategies indicated in ICSI Vision Plan 2010,
- Securing necessary approvals/ clearances from the Council and the Government,
- Monitoring progress of implementation of strategies,
- Taking preventive and corrective actions, and
- Continuous Benchmarking

7. STRATEGIES FOR EXCELLENCE

The preceding discussion clearly indicates that future shape of the corporate world will go a tremendous transformation in terms of structure, operations and societal demands and regulatory expectations. Accordingly, Company Secretaries both in employment and practice, will be the most immediate professionals to meet the consequent growing expectations of the corporate sector.

The Council has adopted following strategies that are vital for development of ICSI as a globally recognised institution:

7.1 Enhancing Cooperation between Members, Students and Staff Members

All strategic management techniques talk about enterprise functions and competition. Customers are treated as outsiders. In an educational institution students pass out and become alumni and they never return. However, this is not so in case of a professional body. A professional is part of professional body and not an outsider. In order to get inside a professional body, he has to pass

prescribed examination or possess requisite qualification.

The recognition of members and students as active players in creating value shifts the focus of core competencies from organisation to enhanced network. Competency is now a function of collective knowledge to the whole system. Outsiders become another source of competence in this enhanced network.

Concept of **ICSI Parivar** on the following principles has been a step in this direction.

- Fairness to all stakeholders
- Mutual Trust, Transparency and Togetherness
- Unrestricted Communication and Continuous Feedback
- Sharing Knowledge, Success Stories and Experience
- Sharing Happiness and Concerns
- Helping Each Other – Round the Clock

The strength of ICSI Parivar is going to be most critical success factor in realising the vision plan. The initiatives are required to involve members of ICSI Parivar to work collectively leading to competency, effectiveness and visibility of the profession and the Institute.

7.2 Repositioning Company Secretaries

The profile of Company Secretaries needs to be expanded to assume role of expert in Corporate Governance in a wider perspective. Wealth creation, management and sharing are objectives of Corporate Governance in broadest sense. Maximum creation and effective management of wealth requires application of best management practices whereas sharing of wealth requires compliance of law in letter and spirit and adherence to ethical standard so as to develop trust between all the stakeholders. Company Secretaries are in a prominent position for management of board affairs at highest level and compliance of law in true letter in spirit. Company Secretaries are imparted wider knowledge of management functions, major laws applicable to a company and are controlled by Professional Code of Conduct of ICSI, so as to ensure ethics in dealings.

Extensive exposure to various dimensions of corporate management in course curriculum and

pre-membership training develop them as corporate managers. Additionally, the exposure to various laws applicable to companies; make them thoroughbred professionals ensuring compliance of laws. In fact, recognizing these professional attributes and expertise, the Company Secretaries have been recognised as Officer-in-Default, Compliance Officer, etc. under the Companies Act and various other laws.

In changing environment, perception of government and industry as well as members needs to be changed about role of Company Secretaries as under:

COMPANY SECRETARY IN EMPLOYMENT

The Company Secretary, a professional bound by the Code of Conduct, aligns various management functions with company policies, ensures compliance of all applicable laws and endeavours to develop mutual trust between various stakeholders leading to good corporate governance and sustainable growth of the company.

COMPANY SECRETARY IN PRACTICE

The Company Secretary in practice is an independent professional, bound by the Code of Conduct, rendering audit, advisory and representation services in relation to management, law and corporate governance processes and practices.

7.3 Strengthening Professional Ethics

Mutual Trust is foundation of any relationship be it between employer & employee, client & practitioner, partners of the firm and so on. A Company Secretary holds a position of trust both in employment and practice. He has access to confidential information of company that is of strategic importance and may also be misused if disclosed to third parties. Hence the person ensuring integrity and independence will be trusted and given higher responsibilities. The biggest difference between a Company Secretary and a Management Graduate (or a PCS Firm and Management Consultancy Firm) is Professional Ethics or applicability of a Code of Conduct under the Company Secretaries Act, 1980.

The Code of Conduct under the Company Secretaries Act 1980 contains various clauses applicable to members of the Institute both in

employment and practice. Code of Conduct prohibits members to:

- Use unethical means to secure professional work
- Disclose confidential information of clients or employer
- Accept fees, profits and gains by way of commission or gratification from lawyer, company secretaries, broker, firm, agent, customer, etc. of the company.

In case the Company Secretary is grossly negligent in performance of his professional duties, he is deemed to be guilty of professional misconduct. Hence, a company secretary is bound to use due skill and care while performing his duties. Infact, he has to ensure that there is no defect or deficiency in the services provided by him.

Hence, a Company Secretary has to ensure highest level of Ethics and Excellence. This is not so in case of ordinary management graduate or consultant.

Therefore, Professional Ethics is the Unique Selling Proposition. The ICSI needs to propagate and emphasise on continuous basis, through various forums, the need for inculcating highest standards of professional ethics, and moral values and adherence to code of conduct of the Institute in its true letter and spirit.

7.4 Good Governance in Institute's Affairs

Good Governance in Institute's affairs is as vital as it is for any other organisation. Good Governance in Institute's affairs should encompass the following:

- Separation of Roles and Authority of Council, its Committees, Secretary and Senior Management
- Inclusion of External Experts in Committees of the Council
- Application of Best Management Practices
- Adherence to Ethical Standards

7.5 Organisational Reengineering

Reengineering is defined as fundamental rethinking and radical redesign of processes to achieve dramatic improvements in critical contemporary measures of performance, such as cost, quality, service and speed [Reengineering the Corporation by Michael Hammer and James Champy].

In order to increase the efficiency and bring about specialisation, the activities of the ICSI need to be divided into three divisions viz. Education & Examination, Professional Development and Membership & Regulation. Adequate resources in terms of funds, human resource and infrastructure should be allocated to these Divisions.

The Education and Examination Division should carry out student services and conduct examination.

The Professional Development Division should arrange for training of students, conduct programmes and short-term courses, coordinate sponsored research and liaise with government, industry and MOU partners for knowledge sharing and joint programmes.

The Membership and Regulation Division should maintain Register of Members and conduct disciplinary action against members. The Company Secretaries (Amendment) Bill 2003 already contains provisions for appointment of Prosecution Director and provision of necessary infrastructure to him.

Reengineering also requires identification of core and non-core processes so that more resources can be directed to core activities and non-core activities can be outsourced.

After making further research on above strategy, the ICSI can proceed with reengineering of all processes to achieve dramatic improvements in critical contemporary measures of performance, such as cost, quality, service and speed.

7.6 Quality Management System – ISO, TQM, Six Sigma, etc.

Quality is the first thing desired from any professional institution since it itself claims to develop quality professionals. The ICSI will get certified for ISO 9001:2000 Quality Management Systems in coming future.

ISO is only a starting point and the ICSI will endeavour to implement other international standards for knowledge-based organisations.

7.7 Knowledge Management

Knowledge has replaced capital as the most important determinant of development. In a path breaking study in mid-1950s, Nobel laureate economist Robert Solow showed that seven-eighth of the growth of US from 1900 to 1950 was accounted for by technical progress, while only one-

eighth was driven by capital. A study by Denison, of factors contributing to the growth of the US economy from 1929 to 1982, attributes 94 per cent of that growth to factors relating to knowledge generation and dissemination: 64 per cent of this is linked to advances in knowledge generation (i.e. R&D) and another 30 per cent to advances in education. Better resource management, which is an application of knowledge, is also identified as a more important factor than capital. This fact bodes well for countries whose economic planners are able to escape from their earlier faith in capital and fully tap the enormous productive potential of non-material, knowledge resources.

The pace of India's future progress will depend to a large extent on its ability to make available the latest and most useful knowledge to vast sections of the population. Similarly, the content and quality of services by a Company Secretary will largely depend on the knowledge he has. Corporate Governance is a wider term and the Vision calls for extensive knowledge creation and management.

7.7.1 Proactive Research Studies

There is need for dedicated and proactive research on contemporary issues so as to have the advance knowledge of business problems and their solutions even when there is remote probability of occurring such problems. Once we have the knowledge about the future events we can prepare our members well in advance so that they can capitalise on opportunities and take on challenges with ease. The original and contemporary research may also add to the revenues of the Institute.

Publications that tell about the future must be released by the Institute, rather than publishing matter after happening of the event. It has to be knowledge rich publication and not merely a post-mortem of events.

7.7.2 Knowledge Warehouse

Knowledge is the most vital resource and its drainage is a serious problem that needs immediate attention. The knowledge shall be pooled from all over the world to develop a Knowledge Warehouse. The members must have access to the knowledge anywhere, anytime and any

manner (Computer, Mobile PDA, SMS, Phone, Fax on Demand, etc).

7.8 Qualitative Professional Development and Continuing Education

Company Secretary holds a very senior position in the organisation. His position requires knowledge of every area of business (may not be in depth), decision-making abilities, leadership qualities and excellent communication skills. Course curriculum, short-term courses and professional development programmes must focus on building strategic leadership amongst the members to set new benchmarks.

There is an immense need for a proactive approach in:

7.8.1 Course Curriculum

The Course curriculum should be compatible with requirements of changing paradigm and profile of services of Company Secretaries. The Course curriculum must focus on the new generation of Company Secretaries whereas Short-term Courses focus on updating members with new skills and develop specialisation.

7.8.2 Pre-membership Training

There cannot be a substitute for learning by doing the job. A student comes to know about actual business environment at the work place only. Pre-membership training tries to fulfil the gap between theoretical knowledge and knowledge required to perform the work effectively. Pre-membership Training is the most important aspect of any professional course. The ICSI need to understand the industry needs and devise a training mechanism accordingly.

7.8.3 Programmes for Members

Professional Development Programmes should focus on new developments in corporate world. Developments in entire gamut of Corporate Governance (as defined by ICSI) must be covered. There should be fixed structure and date for annual programmes. Contents, duration and calendar of other programmes must be finalised in advance and communicated to all the members.

7.9 Human Resource Development

“Successful firms will be those most adept at attracting, developing, and retaining individuals with the skills, perspectives, and experience necessary to drive a global business.” [Ulrich 97a]. Human Resource Development is going to be the most critical for the effective implementation of the Vision Plan.

All the strategies discussed above may not be give expected results if the workforce is not able to implement these. To generate confidence about our human resource we must prepare and get assessed to People-Capability Maturity Model (P-CMM) Level 5 in coming years.

The People Capability Maturity Model (People CMM) is a framework that helps organizations successfully address their critical people issues. Based on the best current practices in fields such as human resources, knowledge management, and organizational development, the People CMM guides organizations in improving their processes for managing and developing their workforces. The People CMM helps organizations characterize the maturity of their workforce practices, establish a program of continuous workforce development, set priorities for improvement actions, integrate workforce development with process improvement, and establish a culture of excellence.

7.10 Infrastructure Development – Focus on IT

Seamless integration through information technology is going to be the key to our success. Each and every member, students, and employees should be connected through a dedicated technology infrastructure. Adequate physical infrastructure across the country and also abroad is also vital so as to provide a meeting place to members, students and outsiders.

7.11 International Networking

Setting up of physical infrastructure in every country may not be a viable option. The only viable option for globalisation of our profession is through International Networking. The strategies with regards making our presence felt into international arena can be:

7.11.1 International Federation of Company Secretaries

In order to enhance international cooperation there is need for an

International Federation of Company Secretaries (IFCS) for developing and promoting the profession of company secretaries. The proposed principal objectives of IFCS include:

- Worldwide development and enhancement of the Company Secretaries Profession
- Advocacy of Company Secretaries Profession including securing entry of “Corporate Governance and Company Secretarial Services” in UN Central Product Classification and WTO
- Assistance in establishing Company Secretaries Institutes in countries not having such Institutes
- Cooperation with institutions/bodies engaged in furtherance of cause of good corporate governance
- Developing Global Research Centre and Global Knowledge Warehouse—a platform for sharing knowledge.

The IFCS may act as a nodal agency to promote the following or any other matter, as may be decided by members of proposed IFCSI:

- Common designation of Company Secretaries (Company Secretary, Chartered Secretary, Corporate Secretary, Certified Public Secretary)
- Common Code of Ethics and disciplinary action process
- Mechanism for dispute resolution between members
- Secretarial Standards for harmonising diverse secretarial practice across the globe

7.11.2 MOUs and Strategic Alliances

Development of both Nation and Company Secretaries requires knowledge. Synergy of vision and action between various constituents of the society and the Institute becomes important for accelerated and balanced growth of society and savings in national costs.

For this purpose the Institute must enter into MOUs/ Alliances with Educational, Research and Professional Bodies, Chambers of Commerce and Industry Associations and International Development Agencies.

unattainable ends. Rather, it is a statement of what we believe is possible for our profession to achieve, provided we are able to fully mobilise strengths and energies, develop the requisite will and make the required effort. It is important to see beyond the limits of the immediate past to rediscover our potential and possibilities

Implementation of Strategies

The implementation is most critical for success of Vision Plan. This document contains broad strategies to be implemented by year 2010. Year-wise Operational Action Plan and Milestones need to be developed and implemented. Adequate resources need to be deployed in order to effectively implement the plans so that desired objectives are met.

The vision must be matched by equal amount of effort to actualise them. Reaching the desired destination requires persistent movement towards the destination. Those who know where they are going and persistently move towards the destination are able to generate support of people having similar thoughts.

8. FUTURE AHEAD

Our vision for the profession serve to awaken in all of us a greater awareness of our core competency, managerial strengths and professionalisation which formed the bedrock of our past achievements and should form the foundation of our future accomplishments. Some of our traditions must change, but knowledge, in essence, is our greatest endowment. The vision should awaken in us an unswerving confidence in ourselves, a complete reliance on our own capacity and an unshakeable determination to realise our full potential. It must emerge as a living and dynamic reality in the minds and hearts of members of the profession.

Commitment of leadership towards faster implementation of the plans is critical since competition is increasing day by day. Competition forces us to continuously innovate and beat the expectation of our clients. Hence focus must be towards providing innovative solutions for growth of its clients.

An essential requirement for envisioning the future of our profession is to recognize that the parameters which determine professional competency have changed in recent years and will change further in future has opened up and will continue to open up greater possibilities than ever before.

The Vision Statement of ICSI serves as a useful starting point and foundation for contemplating future possibilities and our destiny as a global leader. It can serve to indicate the broad lines of policy and strategy by which our profession can emerge as a far stronger, more prosperous in the coming years.

Therefore, realisation of this vision will depend on many things, but most importantly on our self-confidence, self-reliance and determination to make it a reality. For that, we need first of all to abandon the sense of dependence and the urge to imitate other professions blindly. We need also to rediscover the well-springs of our own core competency and strength.

This Vision Statement is neither a prediction of what will actually occur, nor simply a wish list of desirable but

Finally, it is rightly said, "If you can dream it, you can do it". Dreams are possible to achieve with determination. Those who know where they are going, find the way.